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M&A GOES HOSTILE

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BY CATHERINE ARNST

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IN DEPTH

10 WAYS TO CUT HEALTH COSTS NOW

034 | Why wait for health-care reform? Every year, $700 billion is wasted on unnecessary treatments, redundant tests, and other sinkholes. Here's how to cut waste and improve care. | BW |

TAIWAN'S NEW DREAMS

040 | Seeking to escape low-margin PC and semi-conductor businesses, tech players are diversifying into Net devices, smartphones, and even solar power. | BW |

MOST INTRIGUING NEW BUSINESSES

046 | Adverse economic conditions breed smart startups. We picked 25 worth watching. | BW |

Entrepreneur Adrian Ho aims to help clean up the world's most polluting country

(OUTSIDE COVER) PHOTOGRAPH BY TAKA BASED ON A CONCEPT BY GARY NEIL
(THIS PAGE) PAUL HU/ASSIGNMENT ASIA



WHAT'S EATING McDONALD'S

Mickey D's enduring strength was much ballyhooed during the recession, and the fast-food behemoth continues to grow overseas. But at home, rising unemployment is causing sales to dip. BW | PAGE 032



DESIGNS THAT BUILD BUSINESS

The annual *BusinessWeek/Architectural Record* Awards winners show the value of design even in a recession. BW | PAGE 066

006 THE BUSINESS WEEK

006 **EXECUTIVE SUMMARY** Deal mania is back; Comcast and GE get cozy; new GM electric vehicles; Priceline; more

013 **FACETIME** Maria Bartiromo talks to investment strategist Byron Wien of Blackstone

016 **BTW** The sexy sell at Chrysler; Japan's railway suicides; help on performance reviews

018 **BUSINESS OUTLOOK** Jim Cooper says the signs point to job growth—but don't expect it quickly

020 **NUMBERS** Glimmers of hope for U.S. corporate profits

022 NEW BUSINESS

022 **CHINA'S END RUN** As more free-trade deals exclude the U.S., Beijing could dominate a new bloc

024 **TOUGH NUT** Cracking the China market is tougher than foreign insurers thought

026 **M&A GOES HOSTILE** The new wave of dealmaking

028 **INVASION OF THE ANDROIDS** Google plans to keep momentum going by extending use of the new operating system beyond mobile phones

030 **CHARLES WANG'S POWER PLAY** Real estate has become a messy second act for the founder of Computer Associates

032 **WHAT'S EATING McDONALD'S**

033 **STARBUCKS** Pressure to sell its new instant coffee sparks a backlash from baristas

057 WHAT'S NEXT

057 **BLOODIED VIDEO GAMES** As costs soar, the industry is slammed by slackening demand and free games

060 **RUSSIAN POWER PLAY** Gazprom, the bare-knuckle king of natural gas, is out to make its mark in America

062 **INDIA BURNS RUBBER** Why carmakers there are exporting more than their Chinese rivals

064 **SMALL BUSINESS** Even when the economy picks up, small biz plans to keep headcount low

066 **DESIGN THAT BUILDS BUSINESS**

068 **E-CASH IN A FLASH** Soon U.S. cell phone users will be able to make person-to-person payments

069 PERSONAL BUSINESS

069 **MONEY REPORT** Upgrading your munis; a refuge in gold; Texas funds

070 **HOW TO PLAY IT** Taiwan's hot market

071 **INVESTING** Fund manager Michael Winer on dented real-estate debt

072 **INVESTING IN RETIREMENT** Turning pastimes into profits

076 **INSIDE WALL STREET**

079 BUSINESS VIEWS

079 **BOOKS** Cassidy: *How Markets Fail*

082 **TECH & YOU** Steve Wildstrom on the stubborn luxury of Apple

084 **OUTSIDE SHOT** Barry Schwartz says incentives can reward bad moral choices

083 **CORRECTIONS & CLARIFICATIONS**

083 **COMPANY INDEX**

(L TO R) ILLUSTRATION BY THOMAS FUCHS; ROBERT SEALE



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THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD



Outside a Cadbury plant: The company keeps resisting Kraft

DARREN STAPLES/REUTERS; CHART BY DAVID FOSTER

STRATEGY

DEAL MANIA IN THE AIR

More evidence that the smart money senses a global economy on the mend: Takeover activity is humming. The big-daddy deal at present, of course, is **Kraft Food's** Nov. 9, $16.4 billion hostile bid for **Cadbury.** The British sweets purveyor made a sour face, so Kraft has a month to win over shareholders. On the same day, **Google** said it was buying **AdMob,** a provider of mobile ad technologies, for $750 million in stock. Other action: French insurance giant **AXA** and a partner offered $10.2 billion for all of **AXA Asia Pacific,** a partly-owned Australian unit—which promptly rejected the proposal. On Nov. 11, **Hewlett-Packard** said it's planning to buy networking-equipment maker **3Com** for $2.7 billion, including debt. *The Wall Street Journal* reported that **Reynolds American** is near a deal to buy **Niconovum,** a Swedish maker of products to help smokers quit, and that **Motorola** may sell its set-top-box unit. And all this may be just the beginning. **Deutsche Bank** analysts reckon next year could see a major M&A wave. Their reasoning? Capital markets are back on track, confidence is rising, and valuations remain way below pre-credit crunch levels.

| BW | PAGE 026 "Life in a Time of Takeovers"

AN ABOUT-FACE ON E-CARS

While other automakers are stressing electric cars and hybrids, Chrysler is backing away. When the company was owned by **Cerberus Capital Management**, run by **Robert Nardelli,** and begging for bailout cash from the feds—it eventually got $12.5 billion—it pledged to build an array of electric vehicles and put 500,000 of them on the road by 2013. Then along came bankruptcy and a deal under which **Fiat** got 20% ownership in return for contributing small cars and clean diesel engines. On Nov. 4, when Fiat **CEO Sergio Marchionne** outlined plans to spend $23 billion on new models, electric cars were throttled back to a tiny portion of Chrysler's future sales as the company decided to put its cash behind cars that will sell in bigger numbers. In other auto news, **General Motors Chairman Ed Whitacre** contradicted his

M&A DEALS ARE GETTING BIGGER



Data: Bloomberg

*Through Nov. 9

own management—and the **Treasury Dept.**—by saying that GM may not be ready for an IPO in 2010. GM also sent **Nick Reilly,** its international operations boss, to run its **Opel** unit until a permanent CEO can be found.

PRICELINE FLIES HIGH

Forget staycations—consumers are hitting the road again. They're just doing it on the cheap, which is fine with **Priceline.com.** The online travel agency on Nov. 9 posted a tripling of third-quarter profits and a sunny outlook for the rest of the year; the next day its shares soared by 18% to a nine-year high. Despite the recession, a marketing campaign featuring **William Shatner** and the name-your-own-price service led to boffo bookings this summer.

COMCAST'S CONQUEST?

The cable goliath and **General Electric** appear to be nearing the finish line: A Comcast deal for **NBC Universal** may be announced in coming days. Comcast and NBC owner GE have worked out a formula that values the network, its cable channels, Universal studio, and theme parks at $30 billion. Under the accord, Comcast would merge its own channels with NBC, owning 51% of the new company and kicking in as much as $6 billion. GE would hold the remaining 49% but would still need to acquire the 20% stake that French conglomerate **Vivendi** owns. Vivendi is thought to be ready to sell at the right price.

ETHAN MILLER/GETTY IMAGES



Comcast's Brian Roberts seems close to a deal for NBC

ECONOMICS & POLICY

DODD'S REFORM PLAN

Senator Christopher Dodd (D-Conn.), head of the **Banking Committee,** staked out a tough position on Nov. 10 when he unveiled his 1,136-page financial reform package. It would combine banking regulation into a single new agency, stripping the Fed of some powers and handing oversight of "systemically risky" institutions to a panel of regulators. Other ideas, including derivatives reform and a consumer protection agency, resemble those in pending House legislation. The plan drew potshots from banks but little sniping from the GOP, suggesting cross-aisle palaver had preceded going public. Still, much is likely to change before the full Senate votes, as Dodd and his backers all but acknowledged.

"Senator Dodd Unveils Bank-Reform Bill" businessweek.com/magazine

THE RALLY CONTINUES

The dollar may be diving like a blue whale, but investors keep piling into U.S. stocks.

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House Speaker Nancy Pelosi announces passage of the health-care bill

ALEX BRANDON/AP PHOTO

The S&P 500 climbed 2.7% in the three days ended on Nov. 11, notching a 13-month high and raising its 2009 gain to 21.6%. Among the reasons: dandy profits at American companies and reassurances from **Group of 20** finance ministers and central bankers that they'll keep the stimulus spigot open until the recovery is secured. Some 80% of S&P 500 companies that have released earnings this quarter topped expectations—a record since at least 1993, according to Bloomberg. On top of that, nonfarm productivity jumped by an annualized 9.5% in the third quarter, while unit labor costs fell 5.2%. Then there's the downside: U.S. joblessness hit 10.2% in October. And the dollar continued its descent, sliding since March by 15.7% vs. a basket of other major currencies.

| BW | PAGE 018 "The Signs Say: Job Growth Ahead"

HEALTH-CARE MILESTONE

One close vote in the House, one giant leap for health-care reform. After weeks of give-and-take, the **House of Representatives** on Nov. 7 managed to push through a bill by the tiny margin of 220 to 215. One Republican, **Joseph Cao** of Louisiana, voted in favor, while 39 Democrats turned thumbs-down. No sooner was the bill passed than it came under savage attack for failing to curb costs adequately and restricting coverage of abortion-related services. The **Senate** aims to begin debating its version on Nov. 16.

VERDICT: NOT GUILTY

Were they simply lousy money managers, or did they lie to clients? A federal jury in Brooklyn apparently decided on the former, acquitting on Nov. 10 two former **Bear Stearns** hedge fund managers, **Ralph Cioffi** and **Matthew Tannin,** of securities fraud. Many viewed the trial as a test case for prosecutions growing out of the subprime crash. Cioffi and Tannin oversaw funds that collapsed in 2007 after making huge bets on mortgage securities, resulting in $1.6 billion in losses. Prosecutors alleged that they deceived investors, waxing optimistic about the funds while in private they foresaw disaster. But that's often tough to prove, and jurors didn't buy it. Cioffi, 53, and Tannin, 48, still face civil charges brought by the SEC.

11%

Third-quarter increase in U.S. home sales, from the previous quarter

Data: National Association of Realtors

FINANCE

THE GALLEON CASE WIDENS

Ripples from the **Galleon Group** insider trading case are spreading, and the Street is worried. On Nov. 5 federal prosecutors in New York accused 14 more people—including an attorney and Wall Street traders—of trading on nonpublic information. Then, on Nov. 11, *The Wall Street Journal* reported that a key witness told a judge he had bought information from a **Marvell Technology Group** staffer, the first detailed indication that a corporate insider was paid off. Investigators are also tracking transactions at one of the largest and highest-profile hedge funds, **SAC Capital Advisors.**

LEADERSHIP

BENMOSCHE BROUHAHA

AIG CEO Robert Benmosche has made plenty of waves in his three months at the helm, starting with his early bluster about not being pushed into selling assets too soon. On Nov. 11 he found himself in rough water again after *The Wall Street Journal* said he'd threatened in front of board members to quit because of pay limits imposed by Washington, which owns 80% of the bailed-out insurer. Benmosche's own $10 million pay package got the O.K. in October. In a letter to employees, Benmosche didn't deny the report, though he termed it "specula-


TODAY
Thinking green
TOMORROW
Planning for blue
TOYOTA
toyota.com/future
Can today's environmental thinking inspire tomorrow's technology? Toyota believes so. Since its launch, the Prius has earned the love of millions of forward-thinking drivers. We estimate our hybrid technology has saved a billion gallons of gas and lowered CO_2 emissions by billions of pounds.* It's also paving the way for the next generation of environmental vehicles. Like cars charged at home. Or cars that will run solely on electricity, or consume hydrogen and emit only water. Because when it comes to thinking green, the sky's the limit.
*Estimated savings compares each U.S. hybrid vehicle's EPA combined mpg rating with its segment average based on latest EPA Trends Report (driven 15,000 miles annually). Actual mileage will vary. ©2009

tive." He acknowledged his ire over the pay caps but assured employees: "I and the board remain totally committed to leading AIG through its challenges and to continuing to fight on your behalf."

TECHNOLOGY

A ROADBLOCK FOR ORACLE

As Oracle waits, Sun is fading. Back in April, the top database maker offered $7.4 billion for **Sun Microsystems,** which makes computer hardware and software, but on Nov. 9 the **European Union** formally objected to the combo. Regulators fear Oracle's ownership of Sun's open-source **MySQL** database would stifle competition. Oracle disagrees, but with the deal in limbo, Sun continues to burn money. On Nov. 6 it said revenues sank 25% during its first quarter, ended Sept. 27, and losses hit $120 million. The EU has until Jan. 19 to make a final call. U.S. officials have already approved the deal.



SMIC's Chang resigned in the wake of the settlement with TSMC

CHIPMAKERS MAKE PEACE

The feud between the chipmaking kings of China and Taiwan came to an end on Nov. 10 with a victory for the Taiwanese. China's **Semiconductor Manufacturing International** said it agreed with its bitter rival and the industry's top player, **Taiwan Semiconductor Manufacturing,** to settle lawsuits alleging theft of trade secrets. SMIC will pay $200 million to TSMC and give it shares and warrants worth a 10% stake in the Shanghai company, which hasn't made money since 2007. SMIC also said its founder and CEO, **Richard Chang,** had resigned. Despite its history of red ink, SMIC could prove valuable to TSMC, which only possesses one small plant in China. SMIC operates large facilities in Shanghai and Beijing and owns a former **Motorola** chipmaking fab in the northern city of Tianjin.

"TSMC's Next Move in China" businessweek.com/magazine

IDEAS WHY YOU'D BETTER BEWARE OF THE 'BIG SHIFT'

Conventional wisdom says productivity is a key driver of corporate profitability. Yet this long-held assumption is challenged by a report from **Deloitte's Center for the Edge.** The study, led by **John Hagel III** and **John Seely Brown,** finds that despite major improvement in labor productivity over the past four decades, many U.S. industries have experienced "alarming" declines in return on assets (ROA), a key metric of corporate performance (chart). The authors say that trend is being driven by what they term the "Big Shift"—a tremendous increase in competitive pressures, combined with the increasingly pervasive digital infrastructure.



Data: Compustat, Deloitte Analysis

In a follow-up report released on Nov. 10, Hagel & Co. delve deeper into the numbers to figure out how the Big Shift is playing out in nine U.S. industries. Surprisingly, the steepest declines in ROA came in technology, telecommunications, and media—sectors traditionally regarded as innovation hotbeds. The auto industry also had a poor showing, though that's not so startling. Banking, retail, consumer products, and insurance fared better. But only two sectors, health care and aerospace/defense, saw ROA climb. Keep in mind that these industries are subject to heavy government regulation, which tends to muffle competition.

Overall, the Deloitte report provides fodder for those, like *BusinessWeek*'s **Michael Mandel,** who argue that the woes of the U.S. economy extend beyond the financial sector and began showing up well before the housing bubble.

Deloitte's Center for the Edge, "2009 Shift Index"

WANG JIAOWEN/COLORCHINAPHOTO

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FACETIME | MARIA BARTIROMO





BYRON WIEN: WHAT THE SEER SEES IN THE SHORT TERM

Every January since 1986, veteran investment strategist Byron Wien has issued his list of "surprises" for the year. With a little less than two months remaining in 2009, many of his prognostications have already come true. So what has Wien—who last August joined private equity powerhouse Blackstone Group as chairman of its advisory services—been right about this year? Well for starters, a rebounding S&P, the price of oil, the decline of the dollar, the growth rate of China, and the threat of a New York State bankruptcy. He predicted gold would hit $1,200 an ounce. On Nov. 10, gold futures rose to a record $1,119.10. And the year isn't over.

MARIA BARTIROMO
So many of your predictions for 2009 have been on the money, what's your sense of this market rally?

BYRON WIEN
I don't know whether the market is anticipating a better tomorrow in an excessive way, but my prediction for the year was that the S&P 500 would get to 1200, and I'm pretty optimistic that it will reach that point. At 1200, it's fairly priced. So I think it can make progress above 1200, but it'll be slow.

What is driving this momentum?
As far as the economy is concerned, I think businesses fired too many

JENNIFER S. ALTMAN

people, cut inventory back too far, and stopped capital spending. Now business is returning to normal on all three of those points. I think unemployment will peak in the first quarter of next year, more money will be spent on capital equipment, and inventories will be rebuilt. I also think housing has bottomed, and that's going to be a favorable thrust for the economy. As far as the market is concerned, people have been skeptical that it's been going up for the right reasons. Now they're finally giving up and saying they have to get on board.

So bottom line, would you recommend committing new capital to this market at these levels, or would you stay on the sidelines for a little while?
I would definitely not recommend being out of the market totally at this point. But if you've been lucky enough to be in the market for this run, I'd take a few chips off the table.

Do you see a strong market in 2010?
It's kind of hard to know. The stimulus is playing a role, but only about 24% of the stimulus has been spent. So for the first half of next year, I think the economy will be pretty strong. My hope is that investors and businessmen will then regain confidence and begin to invest more heavily. I don't think it'll be a boom year, but I do think we could have 3% growth.

But will we continue to see resilience in the economy and the recovery when the stimulus is gone?
That's something I don't really have the answer to. The purpose of the stimulus was to jump-start the economy, restore confidence, and have the economy build up a natural momentum. It's too early to tell whether that all happened. But I'm an optimist.

"I like technology. Believe it or not, I like health care, even though we're going to have a health-care bill"



On the march in Tehran: Wien says the geopolitical wild card for 2010 will be Iran

Will the Fed have to raise rates?
I think rates are going to stay low for a good part, if not all, of next year.

What areas of the world would you be recommending right now?
I'm still positive on the emerging markets—India, China, and particularly Brazil. But I'm positive on the U.S., too. I like technology. Believe it or not, I like health care, even though we're going to have a health-care bill and a lot of people are interpreting that negatively.

How do you read the mood in commodities?
In the case of oil, we're finding only as much oil as the reserves we're depleting. Also, right now the emerging markets and the Middle East are consuming about 20 million barrels a day, and they will be consuming 42 million barrels a day in 20 years. The reserves aren't going to go up that much, and I don't think alternatives are going to take their place. So I think the price of oil is going up. In the case of gold, the problem is that people have lost confidence not only in the dollar, but also in paper currencies generally, and they want to buy a little insurance. I don't see a dollar rally any time over the near term.

Do you worry that higher taxes next year could slow the recovery?
Well, it depends on what the taxes are. I'm not afraid of the capital gains tax and eliminating the dividend exclusion. I think I'm sort of against this health-care tax. I'm against taxes that destroy entrepreneurship, and to some extent the taxes I just talked about do that, but I don't think they're severe. I'd rather see taxes stay low because I don't think they'll raise that much more money anyway. But on the other hand, the proposals that have been advanced so far, by and large, I don't think will choke off the recovery.

Is inflation a concern?
I think you need wage pressure to produce inflation, and I just don't see any with an unemployment rate of 10% and a lot of people nervous about their jobs.

What are the big risks in 2010 from a global perspective?
The big event risk is if Israel attacks Iran. I'm hopeful some form of negotiation will provide a resolution, but I'm not optimistic about that. Iran is the big wild card in the geopolitical outlook for next year. |BW|

Maria Bartiromo is the anchor of CNBC's Closing Bell and writes the blog Maria Bartiromo's Investor Agenda at investoragenda.cnbc.com

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EDITED BY DEBORAH STEAD



CHRYSLER TURNS ON THE HEAT

Can sex sell cars at troubled Chrysler? On Nov. 4, Chrysler Group (now controlled by Italy's Fiat Group and almost 10% owned by the U.S. government) finally told the world how it plans to storm back: with a dose of Viagra.

At a presentation for auto analysts and reporters, Olivier Francois, the Frenchman in charge of the company's namesake brand, showed a three-minute promotional video infused with glamour, style, and sexual imagery. At one point, a scantily clad model slipped out of a Chrysler, revealing her tattooed thigh. At another, a tagline appeared: "Let's make cars people want to make out in again." In case anybody missed the drift, Francois—who turned around Fiat's top-shelf Lancia brand four years ago—announced to the crowd that Chrysler's cars should be depicted as "models on a runway."

It's hardly the first time Chrysler—or any carmaker—has used sexual innuendo to move inventory. Some years ago, a Chrysler minivan ad included wink-wink allusions to wife-swapping. In another old spot, a kid asks why her sister, sitting in the roomy backseat of her parents' Concorde, is named Concorde. Or consider the "Lingerie Bowl" proposed in 2003 by Julie Roehm, then Chrysler's marketing chief. Her idea: offer a gridiron match between lingerie-clad women as a pay-per-view alternative to the 2004 Super Bowl halftime show. (After parent groups complained, the idea was scratched.)

The new ads aim for sensuality over sex. Still, a friskier Chrysler will be a tough sell. The brand's sales are off 50% this year. And after the new 300 sedan makes its debut in 2010, a batch of fresh cars won't arrive for three more years. "They're trying to show a return to style," says IHS Global Insight analyst John Wolkonowicz. "But you have to have products to match the imagery." How do you sex up a PT Cruiser? *–David Welch*

ILLUSTRATION BY ROSS MACDONALD

CAN BLUE LIGHT SAVE LIVES?

East Japan Railway, which runs local trains in and out of Tokyo, spent $170,000 in October to install special LED lamps on the platforms of all 29 stations along the Yamanote line, one of its busiest routes. The hope is that the blue light emitted by the lamps will soothe any despairing commuters and help reverse an uptick in suicides on the tracks. In the fiscal year ended in March, the company said, suicides on its Tokyo train lines rose for the third year in a row—to 68 from 58 last year, with 18 on the Yamanote line. Across Japan, suicides look to be rising amid near-record-high unemployment. In the first nine months of 2009, Japan's National Police Agency reported 24,846 suicides. That's set to surpass the 32,249 recorded in 2008, when nearly 2,000 people, or 6% of those who killed themselves, did so on rail tracks or using other transportation modes. (In the U.S., from 1% to 2% of all suicides occur on railroad rights-of-way, according to the American Association of Suicidology.)

6%

Share of suicides in Japan involving railways and other modes of transportation

Data: National Police Agency, Japan

The blue-light project grew out of work at East Japan Railway's Safety Research Laboratory. But "there's no research that proves blue lights dissuade people from killing themselves," says Tsuneo Suzuki, who specializes in color psychology at Tokyo's Keio University. Suzuki says he told "desperate" rail operators that "they won't solve a deeply rooted societal problem like suicide by putting up lights." If you showed that was possible, he says, you'd "probably win the Nobel Prize." *–Kenji Hall in Tokyo*



Officials hope the lights on the Yamanote line will soothe would-be suicides

(BOTTOM) PHOTOGRAPH BY TORIN BOYD/POLARIS



SPEAKING FLUENT PERFORMANCE REVIEW

With end-of-year performance reviews looming, it's time to check in with James Neal of Perrysburg, Ohio—the man behind the phrases that pop up in so many employee evaluations. Neal, a former HR executive, publishes *Effective Phrases for Performance Appraisals* (Neal Publications, $12.95). By now, he says, it's a million-seller. (In 1988, the Reagan White House bought 30 copies.)

New in the just-released 12th edition (3,500 phrases): sections on rating employees' awareness of recent privacy laws and copyright issues. "There's a growing concern out there that people aren't following intellectual-property laws," Neal says. To keep up with issues and buzzwords, Neal reads annual reports, focusing on the Chairman's Letter. "Global" is still hot, he says, as are "strategic" and "vision." He started writing the guidebook in 1978 "for the engineering guy who's got 15 draftsmen working for him and needs the right phrases to describe their performance." Remember using CliffsNotes in college? he asks. "It's kind of along those lines."



THE SIGNS SAY: JOB GROWTH AHEAD

Don't expect payrolls to turn around quickly, but economic trends are encouraging. Plus, heady productivity gains are not sustainable, and more workers will soon be needed

In the face of the Labor Dept.'s October employment report, a forecast that job growth is just around the corner might seem downright foolhardy. After all, payrolls continued to shrink last month, and the jobless rate climbed into double digits. Plus, productivity is spiking as companies squeeze more output from fewer workers. Failing a surge in growth far greater than economists now expect, the recovery in the job markets will be painfully slow. Still, signs suggest the healing will at least begin in the next few months.

The most important factor is the economy's return to growth. Economists increasingly expect real gross domestic product to continue to expand at an annual rate near the third quarter's 3.5% pace as overall demand continues to stabilize, businesses restock their exceptionally thin inventories, and financial conditions improve. A growth rate above 3% over two or three quarters has never failed to generate at least modest increases in payrolls.

26.9

Average duration of unemployment, in weeks, as of October, a record high for the U.S.

Data: Bureau of Labor Statistics

Recent trends in two indicators that can foreshadow upturns in payrolls—weekly jobless claims and temporary employment—look especially encouraging. After declining since April, the four-week average of first-time claims fell to 524,000 at the end of October, the lowest since the beginning of the year. More important, given current labor market conditions, economists at JPMorgan Chase say a level of claims close to 500,000 per week is consistent with stable payrolls, a threshold likely to be reached in coming weeks.

In addition, temp jobs have risen for three months in a row, including a 34,000 increase in October. Temps tend to be the first fired in downturns and the first hired in upturns, since the cost of laying off and adding full-timers is much greater. The 44,000 rise in temp payrolls since July is similar to the pace after the last two recessions, when overall payrolls had either stabilized or begun to increase.

Despite these upbeat trends, payrolls have been restrained by near-record productivity growth. Last quarter, nonfarm businesses increased their output by 4%, even as they slashed hours worked by 5%. The October job report suggests the pattern of rising output and falling hours continued into the fourth quarter.

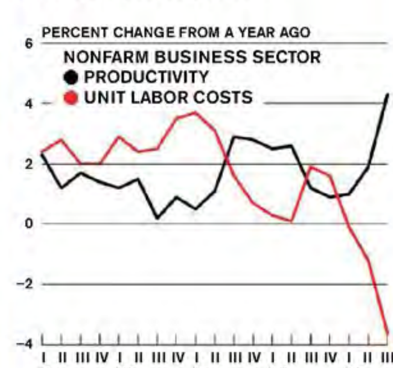
The 8.2% annual rate of productivity growth over the past two quarters, however, is not sustainable. Existing workers and facilities cannot continue to be stretched to that extent in an economy that is growing by 3% to 4%. Much of the recent surge likely reflects a combination of extreme cost-cutting and a surprising third-quarter pickup in demand. As output keeps rising, more workers will be needed.

Some observers worry about a repeat of the experience after the 2001 recession, when productivity gains carried economic growth, even as employment kept falling for 21 months into the upturn. Back then, however, sagging payrolls mainly reflected the recovery's poor 1.9% first-year economic growth, the weakest on record, not the 3.1% pace of productivity. Productivity growth is all but certain to recede toward its 2.2% trend of recent years, a pace that would leave room for job growth sufficient to reduce the unemployment rate gradually next year.

In the meantime, the upside of the surge in productivity is robust profits, which will support business expansion in coming quarters. So far this year hourly wages and benefits have been about flat. Adjusted for productivity, though, labor costs per unit of output have plunged at a record 5.4% annual rate. Companies have the need to expand as demand picks up: Inventories have been liquidated at a record rate, and business equipment is wearing out faster than it is being replaced.

A return to job growth will be the linchpin of a sustainable consumer-led recovery. But keep in mind that consumer spending is already increasing, even as payrolls shrink and the jobless rate hovers at 10.2%. That's the result of spending by those still employed. And if recent upbeat signs from the labor markets are right, income growth should pick up in coming months. |BW|

STRONG PRODUCTIVITY IS SLASHING COSTS



Data: Bureau of Labor Statistics, IHS Global Insight

BRAD TRENT; CHART BY LAUREL DAUNIS-ALLEN/BW


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NUMBERS

GLIMMERS OF HOPE FOR U.S. CORPORATE PROFITS

By Tara Kalwarski/Charts by David Foster

Companies in the Standard & Poor's 500-stock index have come a long way since reporting a collective loss at the end of 2008. Third-quarter numbers so far indicate operating profits of about $137 billion, and more companies are beating analysts' estimates. But net income is still well off peaks in most industries.

At Least They're Positive: In the most recent quarter, real operating earnings hit a level first reached more than 10 years ago.



Data: Standard & Poor's, Bureau of Labor Statistics

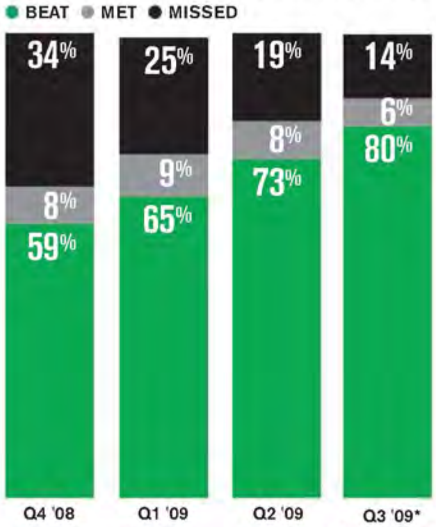
*In Sept. 2009 dollars; Q3 figure is estimated as of Nov. 4

STILL LAGGING

With the exception of health-care companies, corporate bottom lines remain well below their all-time highs.



Looking Better: More companies have beaten earnings estimates.



Data: Thomson Reuters *As of Nov. 6

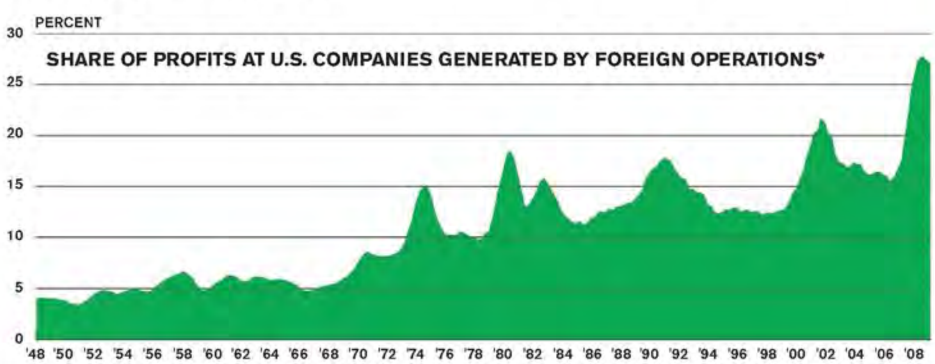
Standouts: A lot of big companies reported triple-digit growth.

S&P 500 COMPANIES WITH THE BIGGEST EARNINGS UPTURN*

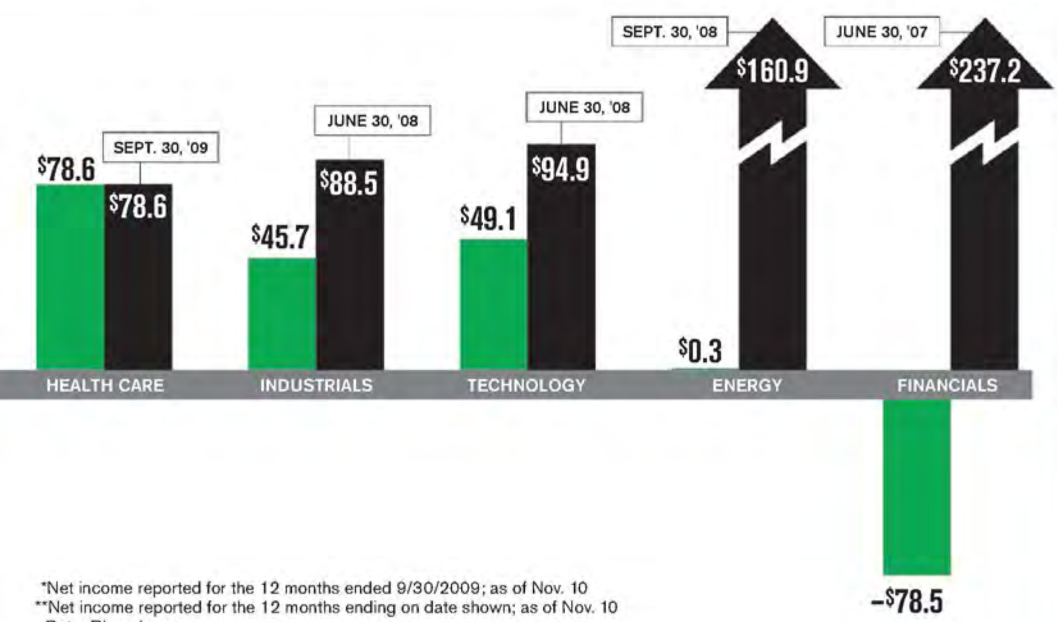
	NET INCOME IN MILLIONS	ONE-YEAR CHANGE
Johnson Controls	$300	1,775%
JPMorgan Chase	3,588	581
Sealed Air	61	559
LSI	53	361
Travelers Companies	935	337
Iron Mountain	43	282
Goldman Sachs	3,188	277
Aflac	363	263
Yahoo!	186	243
Discover Financial Services	578	221

*Among companies reporting by Nov. 4 for the third quarter of calendar year 2009
Data: Capital IQ

Muscle Abroad: More than a quarter of profits at U.S. companies comes from outside the U.S.



Data: Bureau of Economic Analysis, Haver Analytics *Rolling 12-month total



*Net income reported for the 12 months ended 9/30/2009; as of Nov. 10
**Net income reported for the 12 months ending on date shown; as of Nov. 10
Data: Bloomberg

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024 Cracking China's insurance market
026 M&A goes hostile
028 Google's Android invasion
030 Charles Wang's second act
032 What's eating McDonald's
033 Starbucks: Baristas at the gate

CHINA'S END RUN AROUND THE U.S.

As more free-trade deals exclude America, Beijing could dominate a new Asian trade bloc

By Dexter Roberts and Pete Engardio

BEIJING

President Barack Obama makes his first state visit to East Asia on Nov. 13-19. He'll start off in Tokyo, attend a meeting of the Asia-Pacific Economic Cooperation forum in Singapore, travel to Shanghai and Beijing, then finish up in Seoul.

It's a cover-the-waterfront trip, but the focus is on China, America's key trading partner and rival. The Obama team will express its concern that Beijing aims to boost locally owned companies, from commercial aircraft makers to express delivery services, all at the expense of foreign competitors. Washington also wants China, which has more than $2 trillion in foreign reserves, to let the yuan appreciate against the dollar. Finally, Obama and top Cabinet officials will press Beijing to stoke consumer demand at home and rely less on exports to drive growth. Rebalancing the economies of China and other Asia nations "is perhaps the most important thing we can do to restore growth and jobs in the U.S.," explains one senior White House official.

Beijing will likely respond by playing up the country's accomplishments: a huge stimulus package that pumped up spending at home and kept the world from sliding deeper into recession; signs of an increase in consumption; and a modest appreciation of the yuan over the last five years. China's ministers will also point out that Washington has its own work to do, especially in cutting the U.S. budget deficit, bolstering the dollar, and devising regulations to prevent another blowout.

What happens in Beijing next week will undoubtedly be important to U.S.-China trade relations. But trade developments throughout Asia will likely affect the American position in the region as much as, or more than, those meetings in Beijing. Even while it keeps up the dialogue with Washington, China is essentially doing an end run around the U.S. in Asia by pursuing a bewildering variety of free-trade pacts with its neighbors. "What China is doing is very smart and logical," says Linda Menghetti, vice-president of the Emergency Committee for American Trade, a Washington group representing U.S. multinationals. The White House, transfixed by problems at home and its own diplomatic dance with China, trails its rival in sewing up trade deals. The result could be a trade bloc dominated by the mainland.





China's trade diplomats have been exceptionally busy. Next year a deal to drop most duties on farm and manufactured goods goes into effect among China and 10 Southeast Asian nations. A landmark free-trade agreement between China and Taiwan is under discussion, while a financial-services pact with the island could be announced soon. Talks on liberalizing trade terms with Seoul and the Persian Gulf states are under way. China Premier Wen Jiabao just visited Egypt, where the Chinese announced a plan to give $5 billion in low-interest loans and export credits to Africa. In October, Vice-Premier Li Keqiang traveled Down Under to mend relations with commodity-rich Australia and discuss a new free-trade deal with New Zealand. With less success, Beijing has pushed for a regional currency that would weaken reliance on the dollar and increase the role of the yuan.

Why all the hustle? China's total trade volumes are expected to drop 20% this year largely because of the U.S. recession. Beijing has to keep exports growing to keep workers employed, and it needs commodities to turn into finished goods. China also needs other nations as customers and suppliers—if not the U.S., then Korea, Japan, Australia, and others will do.

"Japan can't only rely on relations with the U.S., because Washington's global influence has diminished," says one economist

The Obama visit, meanwhile, may yield some movement on a U.S. pact with New Zealand and Chile. But important free-trade deals with Taiwan and Korea have been held up. One reason is the U.S. approach to these agreements. In its trade talks, the U.S. typically tries for universal, all-in-one deals that cover not only lower tariffs but also services, intellectual property rights, government procurement rules, and even labor and environmental codes. Initiatives by China and other Asian nations, in contrast, focus on simpler, narrower goals, such as a cut in tariffs or easing investment rules.

Chinese companies aren't complaining. After the Southeast Asian trade bloc decided to shed agricultural tariffs and ease manufacturing and property investment rules for Chinese companies, for example, Nanning-based Guangxi State Farms Group signed deals worth more than $620 million in the region. The U.S. has been talking about joining the same trade group since 2002. The delay puts American companies at a disadvantage, says Karan Bhatia, a former U.S. trade negotiator who now is General Electric's vice-president and senior counsel for international law.

CHANGING PERCEPTIONS

Most manufactured goods made in Southeast Asia will now enter China duty-free. But goods shipped from the U.S. will still face average duties of 9%. "That is a meaningful differential," Bhatia says. Much like Nafta, which prompted many global companies to produce in Mexico in order to export duty-free to America, many U.S. manufacturers will have to go to Southeast Asia to have better access to China. That would be bad for U.S. exports.

Obama is aiming to change the perception of American indifference. Trade issues will be on the agenda in Seoul and Tokyo as well as in Beijing, and Obama's team will include top economic officials Treasury Secretary Timothy Geithner, Trade Representative Ron Kirk, and Commerce Secretary Gary Locke, as well as Energy Secretary Steven Chu.

The message, says White House foreign policy spokesman Ben Rhodes, is that "the President is very committed to being competitive in this region." The Administration also knows that American executives are getting nervous. "What the companies are expressing is a strong interest in the U.S. being engaged in [Asia]," says the senior White House official. "That is our position, not to sit on the sidelines."

Rather than bringing concrete proposals, though, Obama is likely to talk in generalities, says Ernest Bower,

ILLUSTRATIOIN BY BRIAN STAUFFER

Southeast Asia director at Washington's Center for Strategic & International Studies. "We are coming without any goodies in our basket," he adds.

The change in thinking in Tokyo and Seoul illustrates Washington's problem. In Japan, new Prime Minister Yukio Hatoyama aims to forge a trade group with China and South Korea. Rising exports to China have helped Japan's economy survive a plunge in trade with America. "There's a consensus among policymakers that Japan can't only rely on relations with the U.S., because Washington's global influence has diminished," says Keio University economist Masaru Kaneko.

It's a similar story with Korea: In 2002 the U.S. took 20% of Korean exports. In the first 10 months of 2009 the American share dropped to 10.5%, while China accounted for nearly 24%. No breakthroughs in U.S. trade talks with Korea are expected. "I'm sure we will hear lip service about moving the Free Trade Agreement forward," says Lee Si Wook, a trade expert at the Korea Development Institute, a government think tank. "But actions will be lacking." |BW|

–With Moon Ihlwan in Seoul, Frederik Balfour in Hong Kong, Kenji Hall in Tokyo, and Jane Sasseen and Steve LeVine in Washington

Business Exchange

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Will China Boost Africa?
Asia isn't the only region where China has been boosting its influence. Since 2002, Beijing has poured $29.3 billion into Africa, with a goal of securing access to vital commodities such as oil and minerals. Yet a recent article in *Foreign Policy* questions whether the citizens of poverty-stricken nations like Gabon, which awarded a $3.5 billion mining contract to a Chinese consortium in 2006 under very favorable terms, will see any benefits from such investments.

To read the story, go to **http://bx.businessweek.com/african-business/reference/**

A SLOG IN CHINA FOR FOREIGN INSURERS

How mainland rules are giving an edge to domestic rivals

By Frederik Balfour

When insurer AIA moved back into its gray stone colonial headquarters on Shanghai's waterfront Bund in 1998, it marked the return of foreign insurance companies to China after their ejection nearly five decades earlier. Since then the floodgates have opened as Cigna, AXA, Allianz, and dozens more have set up shop on the mainland, aiming to tap a market of 1.3 billion people with few options for life insurance.

As it turns out, their optimism may have been overblown. While there's vast potential—life insurance premiums represent just 2.2% of China's gross domestic product, vs. 13.6% in Taiwan and 9.9% in Hong Kong—cracking the market has been tough. In June foreign companies took in only 4.7% of premiums paid in China. Their revenues have been on the rise, but that's a big step backwards in share: In 2007 foreigners had 8% of premiums, according to the China Insurance Regulatory Commission.

4.7%

Market share of foreign companies in China's life-insurance market

Data: China Insurance Regulatory Commission

The newcomers underestimated the strength of China's incumbents. China Life, Ping An, and other domestic insurers enjoy tremendous name recognition. And they can have nationwide licenses, while foreigners need separate permission for every new city or province where they want to do business. "There is clearly an uneven playing field," says Gary Bennett, China chief for New York Life, which has a joint venture with Qingdao-based appliance maker Haier Group. "It's a fact that there is some level of protectionism." While Beijing doesn't explicitly acknowledge that, some mainlanders say domestic insurers need a leg up to survive. "There is a general sense that this industry is in its infant stage and needs to be protected," says Jin Feng, a former government official who now runs CNinsure, a Guangzhou insurance brokerage listed on Nasdaq.

ODD PAIRINGS

Then there's the problem of joint ventures. Virtually all foreign insurers in China must work with local partners, and these often lack any experience in the industry. Canada's Manulife Financial, for instance, is teamed up with state oil company Sinochem, while the U.K.'s Aviva is partnered with food conglomerate Cofco. Relations in joint ventures can be strained under any circumstances, and in insurance—where it may take a decade or more before profits start flowing—it's doubly difficult. "There are frictions between the partners when more cash is required for expansion," says UBS analyst Kenneth Lo.

A further concern for the new entrants is the underdeveloped state of China's capital markets. The bond market is small and illiquid, and it often takes good connections to get in on primary issues. So the foreigners have a harder time than their domestic rivals in buying assets to assure the predictable income streams needed to meet payments on policies years from now. "It's an ongoing problem," says Simon Machell, Aviva's Asia chief, "of taking on liabilities of up to 25 years when the availability of long-dated assets in China is quite limited."

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M&A GOES HOSTILE

Unfriendly bids—like Kraft's for Cadbury—are rising, and defenses are weaker



Kraft CEO Rosenfeld has been playing hardball with Cadbury

By Jessica Silver-Greenberg

With the economy on the mend, cash-rich companies are ready to make deals again. But many targets, wary of lowball offers, aren't willing to sell. The latest standoff: Kraft Foods vs. Cadbury. On Nov. 9 the U.S. packaged goods maker decided to take its \$16.3 billion bid to shareholders of the European candymaker after getting spurned by the board in September.

Hostile takeovers are back. Since the downturn began in 2007, unsolicited bids have accounted for 11% of announced acquisitions in the U.S. That compares with an average of 6.8% over the past decade, according to Dealogic. "These deals are heating up and will continue," says Michael G. O'Bryan, an M&A attorney with New York law firm Morrison & Foerster. After resisting for eight months, biotech company Genentech agreed to a \$46.8 billion acquisition by drugmaker Roche. PepsiCo is still trying to persuade Pepsi Bottling Group to make a deal for \$4.2 billion.

Why are buyers getting so aggressive? Vulnerable companies, whose share prices have been battered, may be in a state of denial. Some targets think they're worth way more than their current market value and are unwilling to accept deals even when the suitor plans to pay a nice premium. "Companies have gotten used to buyers factoring future earnings into the offer price," says Paul Weisbrich, a senior managing director at investment bank McGladrey Capital Markets. "Now buyers are saying, 'Hell, no.'"

That attitude is being reflected in some recent bids. Kraft initially offered \$16.7 billion for Cadbury in September, roughly 31% above its market value then. When the Cadbury board balked at the price, Kraft CEO Irene Rosenfeld refused to budge. Two months later, Kraft even cut the bid slightly to \$16.3 billion. "Kraft's offer does not come remotely close to reflecting the true value of our company," says Cadbury Chairman Roger Carr. Says a Kraft spokesman: "We believe this offer is fair and attractive."

LESS POTENT POISON PILLS

Vultures may have more success than in the past. In recent years shareholders have stripped companies of many traditional takeover defenses, fearing directors would use them to reject deals that were in the best interest of investors. Among the casualties: so-called staggered boards in which only a few members come up for election each year. That prevents corporate raiders from staffing the entire board with sympathizers. Fewer than 35% of companies in the Standard & Poor's 500-stock index have staggered boards, compared with 60% in 2002.

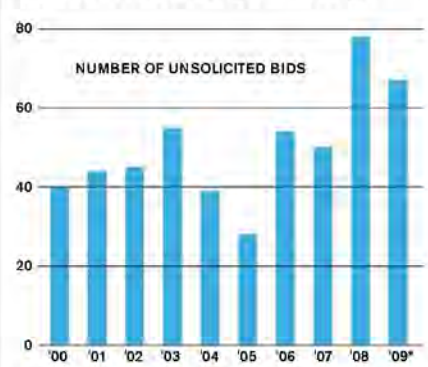
Multiyear poison pills have also lost favor. The plans can deter a takeover by giving management-friendly investors the right to buy a large number of shares, thus diluting the hostile bidder's stake. During the 1980s, they became a popular method of blocking raiders such as Carl Icahn. But in the 1990s investors railed against the long-term policies, which often extended up to 10 years and didn't require shareholder approval.

Boards are finding ways to spruce up this tactic for modern times. Some companies are introducing short-term poison pills that can be deployed only for a specific period of time, say, 12 months or less. Investors find the new version more appealing than the old one: It can be used to briefly ward off unattractive buyers while still ensuring that boards will consider other offers. In September, Facet Biotech adopted a one-year poison pill after snubbing a deal from rival Biogen Idec.

And more boards are asking for shareholders' permission before instituting poison pills. This year 26 companies, including builder KB Home, have planned to put such policies to a vote—the most of any year in the past decade, according to researcher RiskMetrics Group. Says Morrison & Foerster's O'Bryan: "Targets are adapting" to the new environment. |BW|

—With Tara Kalwarski in New York

UNWANTED OFFERS



Data: Dealogic *Through Nov. 10

PHOTOGRAPH BY JOHN GRESS/REUTERS; CHART BY RAY VELLA/BW

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THE GREAT ANDROID INVASION

Google is not only coming out with new mobile apps but extending the system's use to other devices



Google's Rubin: "The worst thing would be one operating system"

By Olga Kharif

Andy Rubin, the mastermind behind Google's Android, has had a pretty good few weeks, with major companies throwing their weight behind his operating system. Yet Rubin, 46, says he's just getting started. In the next few months he expects to unveil major enhancements to the programs available for Android phones, including some to make them more useful for business. He's also pushing Android beyond mobile phones: A half dozen other devices will soon come out with the software, including e-book readers, netbooks, and TVs. "There are still a lot of areas where we could do a lot better," he says.

There's good reason for the grand ambitions. Rubin doesn't think Google necessarily needs to eclipse the most popular mobile phone operating systems, like those used by Nokia, Apple, and Research In Motion. But he wants Android to be powerful enough that other phone makers and wireless companies feel pressure to come up with innovations—and to keep their devices open so users can access services like Google's search. "The worst thing would be one operating system," Rubin says.

Android is far from a major player today. Despite a splashy debut this month from Motorola's Droid phone, which uses the software, fewer than 1% of mobile phones run Android. "There's not much Android awareness," says analyst Ken Dulaney of researcher Gartner.

Still, Google is picking up allies. Mobile-phone makers and app developers have been impressed with the company's progress, particularly with the version of Android that debuted in October. "It's absolutely top-notch," says Alex Galvagni, chief technology officer at Glu Mobile, which makes games for Android and Apple's iPhone.

Rubin's focus now is coming up with new capabilities to build on the momentum. His biggest push will be into Google services that set Android devices apart. One example is the free Google Maps Navigation, which offers turn-by-turn voice guidance and 3-D views. Rubin won't specify what else Google will cook up, but two possibilities are a book reader, which would let users browse thousands of books Google has scanned, and a pared-down Google Docs, which would let people write and edit on their phones.

One effort is around business users. Android phones can now handle e-mail and scheduling data from Microsoft's Outlook, the most widely used program in the field. Developers are also coming up with a flurry of new apps, including Scan2PDF Mobile, which lets users scan documents using their phone's camera and then convert them to PDF files.

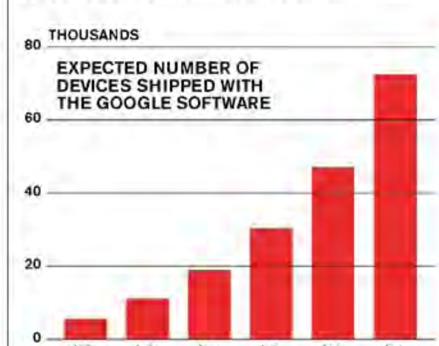
MIGRATING AND MUTATING

Android is making the leap to other devices because Rubin and his team have adapted the software for different screen sizes and functions. Barnes & Noble chose Android for its upcoming nook e-reader because of its flexibility and power management. "We thought it suited us well," says William Lynch, president of Barnesandnoble.com.

Rubin knows his team is going up against fierce rivals. But he's putting a lot of pressure on himself to compete. If the best digital products can't be made with Android, he says, "I would consider myself a failure." |BW|

–With Douglas MacMillan

ANDROID RISING



Data: Ovum

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030

CHARLES WANG'S MESSY SECOND ACT

The ex-CEO of '90s highflier Computer Associates is trying real estate. But his past won't stay behind him



HENNY RAY ABRAMS/AP PHOTO

By Steve Hamm

New York entrepreneur Charles B. Wang, who made his mark in software, is busy reinventing himself as a real estate tycoon. He's pushing a mammoth $3.8 billion mixed-use development in suburban Hempstead, Long Island, surrounding the Nassau Coliseum, where his New York Islanders hockey team plays.

Since the project will include a fix-up of the Coliseum, which the plain-spoken Wang calls a "dump," it has won the backing of pols, including Senator Charles Schumer (D-N.Y.). But Wang is running into resistance from local leaders over concerns that the 150-acre development will adversely affect traffic and the environment.

After waiting nearly two years to get the project approved, Wang is threatening to uproot the Islanders if Hempstead doesn't O.K. his plans soon. Tensions are escalating. "I don't give him a deadline for delivering the Stanley Cup to Long Island, and he shouldn't give us a deadline for approving his project," says Kate Murray, the Hempstead supervisor.

Wang seems to attract controversy. In the go-go 1990s, when he ran software giant Computer Associates, he cut a ragged path through the tech industry with dozens of layoff-causing acquisitions and rancorous relations with corporate customers. Then the company imploded amid Justice Dept. charges that its executives had violated accounting and securities laws. Eight of them went to jail. But Wang, the company's chairman during the period investigated, was not prosecuted.

Hard as he tries, Wang is having difficulty leaving his past behind. His former company, renamed CA, last month filed court papers seeking to recover compensation it paid to Wang, including a $600 million-plus performance bonus. "CA's Special Litigation Committee concluded that Mr. Wang knew of, directed, and participated in the premature recognition of revenue," says Gary Brown, the company's chief compliance officer. Wang denies any culpability. Of CA's effort to recover money from him, he says: "What they've done is shameful. They should focus on the business and move on."

$3.8 billion

Estimated cost of Wang's massive real estate project on Long Island

CONCILIATORY NOTE

The company's claim is based in part on a jailhouse deposition by former CA Chief Executive Sanjay Kumar, who is serving a 12-year sentence in a minimum-security federal prison in New Jersey. Kumar stated that Wang "personally directed" the illegal accounting practice that landed him and the other CA managers in jail. Wang rejects Kumar's allegation: "He's the one who pleaded guilty." Through his lawyer, Kumar declined comment.

Wang claims his Long Island project would create 19,000 permanent jobs

Wang insists that his critics have him all wrong. He claims his real estate plans are motivated partly by his love for Long Island, where he grew up after immigrating from China at age 8. Wang's project is the largest development proposed on the island since the building of Levittown after World War II. Says Wang: "It could be a catalyst for the rebirth of Long Island," an area that has lost a lot of manufacturing jobs. Wang claims the 42-building development would create 19,000 permanent positions. Even though he's impatient with the slow progress, Wang is sounding a conciliatory note. "I have never said I won't compromise," he says.

F. Scott Fitzgerald, another fan of Long Island, once wrote: "There are no second acts in American lives." Wang has proven Fitzgerald wrong, but it remains to be seen whether his second act will end better than his first. |BW|

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McDonald's stumbled by keeping prices up as consumers cut spending

WHAT'S EATING McDONALD'S

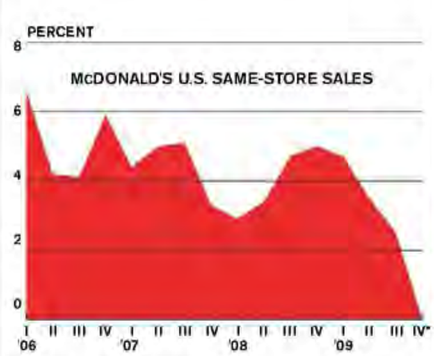
Its strength through the recession was much ballyhooed, but now sales are slipping

By Matthew Boyle

You'd think McDonald's would be a can't-miss recession play for global investors. Yet shares of the fast-food giant are flat in 2009 during one of the most dramatic stock rallies in history. While the burger giant keeps growing overseas, same-store sales in the U.S., where McDonald's generates half its operating profits, dipped 0.1% in October and are likely to stay weak for the rest of the year. In response, McDonald's will soon launch a dollar breakfast menu and add smoothies to its lineup.

The problem: Rising unemployment, particularly among men aged 18 to 35, has slowed customer traffic. According to data tracker NPD Group, visits to fast-food restaurants declined 3% over the summer, the worst performance in decades. Traffic is notably weaker during the morning commuting hours, when McDonald's makes 25% of its sales. "That has really become a major negative for them," says Ronald N. Paul, president of restaurant consultancy Technomic. Moreover, families increasingly are eating at home: NPD says Americans will average 202 meals at restaurants in 2009, down from 211 in 2001. Thanks to improved operations, savvy marketing, and new items such as premium salads, McDonald's has posted 26 consecutive quarters of positive same-store sales in the U.S. But those buoyant sales have also been attributable partly to price hikes of as much as 10% in markets such as the Western U.S., according to internal documents circulated to franchisees that were reviewed by *BusinessWeek*. The price increases were a response to soaring costs for such ingredients as meat and cheese in 2008. While those costs have eased, McDonald's, like other fast-food chains, has kept its prices steady in an effort to maintain margins. As a result, says one divisional executive for the chain, "We're pricing ourselves out of the market" as consumers continue to pinch pennies.

NOT LOVIN' IT



Data: Janney Capital Markets *Estimate

To counter weaker demand, the Oak Brook (Ill.) company plans to extend its successful dollar menu to the breakfast hours beginning in January, according to internal documents. McDonald's has already been testing items such as $1 Sausage McMuffins in some markets, including the Southeast. One longtime franchisee who's doing so says customer visits have increased 5%, but overall breakfast sales have not improved.

DESIGNER COFFEE

McDonald's hopes the low-priced breakfast items will also boost sales of the company's premium coffee offerings, dubbed McCafé. Despite the hype so far, insiders say McCafé has not been the game-changer McDonald's had anticipated. "They're not lighting the world on fire," says the franchisee. The company plans to expand McCafé next summer to include smoothies.

What McCafé has done, some argue, is siphon off advertising dollars that could have been better spent battling McDonald's burger rivals, who are attacking the No. 1 chain with gusto right now. One notable advertising spot from Wendy's claims that McDonald's uses frozen burger patties. A McDonald's spokesperson declined to comment.

With jobless numbers likely to rise well into next year, analysts are skeptical about the company's prospects in its home market. "This has been a remarkable run, but they need to turn around U.S. same-store sales," says Jeff Farmer, an analyst at Jefferies & Co. "And that's very difficult to do." |BW|

ILLUSTRATION BY THOMAS FUCHS; CHART BY RAY VELLA/BW

THE STEAM AT STARBUCKS

Baristas are angry and customers put out over the aggressive rollout of (heavens!) an instant coffee line

By Susan Berfield

Starbucks instant coffee was always going to be a tough sell. That's why the company spent years developing it and months preparing its frontline employees (aka baristas) for the Sept. 29 launch of Via, three-packs of instant that go for $2.95. "We took a lot of time with it because we knew it could undermine the company if we didn't do it right," CEO Howard Schultz said this summer.

It's too early to say whether Via is a success. But judging from the coffee blogs, including the company's mystarbucksidea.com, for some baristas the pressure to sell Via is intense and unwelcome. "This is the most stressful promotion I have ever experienced, and I've been with the company for seven years," a barista wrote on starbucksgossip.com. Some customers are finding the hard sell a bit exasperating, too. As one wrote: "Please no more high-pressure Via sales pitches. It's annoying ... it's completely out of line with Starbucks' vibe."

That Starbucks would even create an instant coffee is surprising enough. After all, the company celebrates the ritual preparation of coffee, and the sense of comfort, indulgence, and sometimes community that its customers experience. It is telling that, before introducing Via in three test markets, the company told employees an elaborate story about its creation: that it was a two-decade-long quest begun by a researcher named Don Valencia; that Valencia passed away before scientists at the company finally came up with a micro-grinding technique that allowed Starbucks to make an instant coffee that passed the exacting Schultz taste test; and that the name itself is in part homage to Valencia.

In the weeks before the official launch, Starbucks held pep rallies for employees in nearly 100 cities in the U.S. and Canada. Managers instructed baristas about how to strike up conversations about Via with their customers. And for the first time ever, Starbucks unveiled a national TV and print advertising campaign focused on a single product.

Starbucks sees great potential in Via: Instant coffee is a $21 billion global market. And Starbucks made a significant investment in Via, the biggest product rollout in its history. Naturally, executives set ambitious sales goals. There, perhaps, lie the roots of the problem. Starbucks baristas typically think of themselves as akin to bartenders, not salespeople. "We were just told to place a Via 12-pack in the customer's hand while asking if they would 'like to add some Via to their order,' " blogged one barista. "I have seen more annoyed customers than enthusiastic ones from all these strong-arm sales tactics. ... Not to say it's not a good product. I think it just needs to be kept in the supermarkets next to the other Starbucks mass-market frill."

Instant coffee is a $21 billion global market, so sales goals for Via—three packets for $2.95—are ambitious

The company won't provide any specific information about Via's sales so far except to say that the product has been incredibly well-received. Clifford Burrows, president of Starbucks Coffee U.S., has seen the criticism of the sales tactics and says: "I've read it, but the general spirit is one of enthusiasm about Via. Some will find it easier to sell than others, some stores will be more successful than others." |BW|



Starbucks Coffee U.S. President Burrows downplays the resistance

BRIAN SMALE

10 WAYS TO CUT HEALTH-CARE COSTS RIGHT NOW

By Catherine Arnst

Photograph by Taka
Illustrations by Gary Neil

Employers and hospitals don't have to wait for Congress to address inefficiencies and waste

Seven hundred billion dollars. That's a ballpark estimate of how much money is wasted in the U.S. medical system every single year, according to a new Thomson Reuters report. A sum equal to roughly one-third of the nation's total health-care spending is flushed away on unnecessary treatments, redundant tests, fraud, errors, and myriad other monetary sinkholes that do nothing to improve the nation's health. Cut that figure by half, and there would be more than enough money to offer top-notch care to every one of America's 46 million uninsured.

None of the health-care reform bills on the table in Washington do anything meaningful to address that wasted $700 billion. Nor do they call for changes in the underlying flaw that drives much of the waste—the fee-for-service system that pays doctors and hospitals for the amount of medical care delivered rather than for its quality. Under fee-for-service there is no financial incentive for doctors to eliminate waste, since they wouldn't pocket any of the resulting savings. They would just earn less.

By leaving this perverse reward system in place, Congress is virtually guaranteeing that health-care reform legislation, if passed, will do nothing to "bend the curve" of rising health-care costs, as President Barack Obama originally set out to do. Even the few cost-cutting efforts that the bills do include won't go into effect until at least 2013. As a result, U.S. health spending is on track to double over the next 10 years, to $5.2 trillion, about 21% of the gross domestic product.

Or possibly not. Politicians may be reluctant to rein in the medical-industrial complex, but the private sector is forging ahead. Faced with health-care costs that keep rising 6% to 7% every year—even during this year of negative overall inflation—plenty of insurers, hospitals, employers, and communities are figuring out how to offer better care for less money. They are willing to take experimental leaps in an attempt to solve some of the health system's most intractable problems.

A BIG STEP FORWARD

BusinessWeek has looked at 10 such attempts to lower health-care costs and improve patient care. These innovations cannot have the same impact as a comprehensive federal bill. Nor are the gains from private efforts assured. Paul B. Ginsburg, president of the nonprofit Center for Studying Health System Change, cautions that "there are a lot of things we know can improve health, such as wellness programs. But we don't know if they can save money on a large scale."

Still, companies and hospitals are taking the initiative, and some results are in plain view. "Three years ago, professional medical organizations were very reluctant to talk about inappropriate treatments, but I already see that changing," says Robert Kelley, vice-president for health-care analytics at Thomson Reuters. He points out that the American College of Cardiology recently published several standards of care for angioplasty and other common treatments, aimed at preventing unnecessary and costly interventions. Given that about one in six U.S. health-care dollars is currently spent on cardiovascular procedures, "that's a big step forward," says Kelly. Here are some others.


Stainless Steel



1 CRACK DOWN ON FRAUD AND ABUSE

Crime pays big when it comes to health care. This huge industry is run pretty much on the honor system. As law enforcement agencies have cracked down harder on illegal drugs, organized crime has diverted resources into multimillion-dollar medical scams, where there is less chance for detection. The FBI figures that fraudulent billings to Medicare, Medicaid, and private insurers account for 3% to 10% of total health spending, and the bureau concedes its estimates may be low. "Everywhere we look, we see evidence of fraud," says Lewis Morris, chief counsel for the Office of the Inspector General at the U.S. Health & Human Services Dept.

Medical fraud can range from fake claims to kickbacks to doctors to rigged payment schemes spanning several states. For years private insurers relied on law enforcement to chase down scams, with little effect. Now the industry is seizing the initiative. The Blue Cross & Blue Shield Assn. reports that its antifraud efforts resulted in savings of $350 million last year, a 43% increase from 2007. "Previously we had claims people investigate fraud," says Lee S. Arian, head of WellPoint's antifraud unit and a former federal prosecutor. "Now we hire law enforcement professionals with experience investigating crime."

Insurers are also trying to stop crime before it starts. Anthem Blue Cross of California came up with a strategy designed to identify so-called phantom providers of medical equipment, phony companies set up to file fake reimbursement claims. Working with federal files on fraudsters, Anthem fingered 10% of 500 newly registered companies as fakes. An added bonus: News coverage of the effort caused requests at Anthem for new provider ID numbers to drop dramatically.

$125-175 billion

Losses attributed each year to fraud, ranging from spurious Medicare claims to kickbacks on referrals for unnecessary services

Data: Thomson Reuters

2 DEVELOP A HEALTHY WORKFORCE

When Johnson & Johnson CEO William C. Weldon met with President Obama over the summer, he communicated a key message: Prevention pays. Weldon knows, because J&J has been offering comprehensive wellness programs to its 100,000 employees since 1995. Internal studies found that in the four years ended in 2002, those efforts saved $225 per employee per year.

J&J's experience proves wrong the conventional medical wisdom that it takes decades before efforts to help people develop healthier lifestyles can produce savings. Although many workplace wellness programs are little more than window dressing, serious efforts can yield important reductions.

J&J offers a huge array of programs, including free smoking cessation classes, online tools for weight and stress management, and 30 on-site fitness centers. Employees who enroll get a $500 discount on their insurance premiums. About 85% of employees participate as a result. "Seventy percent of health-care costs could be prevented through lifestyle modification," says Dr. Fikry W. Isaac, J&J's executive director of global health services.

3 COORDINATE CARE THROUGH FAMILY DOCTORS

A patient suffering from one or more chronic diseases may depend on several doctors, and rarely do they communicate with one another. This lack of care coordination means it's nearly impossible to arrange complementary treatments, cross-check prescriptions, and avoid ordering the same diagnostic tests over and over. The resulting duplications and follow-up care cost the nation $25 billion to $50 billion a year.

A solution is emerging from the medical trenches in the form of the "patient-centered medical home." Under this model, a primary-care doctor is the point person for all of a patient's medical needs, organizing care with specialists, pharmacists, and physical therapists and sharing electronic medical records with all. A 2004 study estimated the U.S. health-care bill could fall by 5.6% if every patient had a medical home.

North Carolina is already reaping savings. In 1998 the state set up Community Care of North Carolina (CCNC), a partnership between the state and some 4,000 primary-care doctors. Enrolled in the program are 870,000 Medicaid recipients and 97,000 children. CCNC pays doctors Medicare rates plus a monthly fee of $2.50 per enrollee to cover the extra time the doctors need to manage overall care. A Mercer study found that the program saved the state $161 million on health-care costs in 2006 alone.

$250-325 billion

Annual spending on unnecessary care—from overuse of prescription antibiotics to lab tests performed to protect against malpractice suits

Data: Thomson Reuters

4 MAKE HEALTH A COMMUNITY EFFORT

We are not a fit nation. One-third of U.S. adults are obese, and health spending on this group grew 80% from 2001 to 2006, to $166.7 billion. Rochester, N.Y., has decided to do something about it.

In 2005, Wegmans Food Markets CEO Danny Wegman recruited six other local employers, including Bausch & Lomb, Eastman Kodak, and Xerox, along with the Rochester Business Alliance, to set up a health and fitness program for all of the metropolitan area's 1.04 million people. The campaign, called "Eat Well. Live Well," challenges individuals to eat five cups of fruit and vegetables and walk 10,000 steps each day. More than 44,000 people have participated over the past three years, making it the world's largest wellness program.



The group's collaboration didn't stop at fitness. The companies joined with doctors and insurers to substitute generic drugs for brand-name medicines, had their own efficiency experts help three hospitals streamline operations free of charge, and contributed $685,000 toward establishing a regional electronic health records system. Wegmans Vice-Chairman Paul S. Speranza says Rochester's health costs have dropped from 5% below the national average in 2005 to 15% below this year. "We believe collaboration, in Rochester or nationally, is the answer," he says, "whether there is legislation or not."



5 STOP INFECTIONS IN HOSPITALS

Far too often, the biggest danger to patients is not their disease but the hospitals that treat them. Every year 1.7 million patients develop infections while in hospital, and 99,000 die as a result. These hospital-acquired infections add $30 billion to the nation's annual health-care bill—and almost all are preventable. "For a long time there was a sense that a lot of these infections were inevitable," says Dr. Donald Goldmann, senior vice-president of the nonprofit Institute for Healthcare Improvement. "But in the last five or six years medical professionals have come to realize we can do a lot better if we follow a zero-tolerance policy."

The key is keeping the hands and clothes of hospital personnel clean, as well as any tools that come in contact with patients. In 2001, Dr. Peter Pronovost of Baltimore's Johns Hopkins Hospital came up with a five-item checklist that proved highly effective at curbing contamination. It calls for all staff to wash their hands before touching patients; clean patients' skin with strong antiseptic; wear masks, caps, and gowns; and take other common-sense precautions. Using the list, the Keystone Project, a collaboration of 77 Michigan hospitals started in 2003, reduced catheter-related infections to zero. The state hospital association estimates 1,700 lives and $246 million were saved in the project's first three years. Keystone is now being rolled out to all 50 states.

6 GET PATIENTS TO TAKE THEIR MEDICINE

Three out of four Americans do not take their medicine as directed. This noncompliance leads to additional doctor visits, hospitalizations, and treatments that together add some $177 billion a year to the nation's health-care bill, according to the National Council on Patient Information & Education.

People don't take their pills because they forget, they don't think the drugs work, they neglect to refill prescriptions, or they can't afford the medications. To address the problem, GlaxoSmithKline and the American Pharmacists Association Foundation joined forces four years ago to start the Diabetes Ten City Challenge. Pharmacists closely monitored the medications of more than 1,000 participants at 30 companies and waived co-pays for prescriptions. Average care costs dropped nearly $1,100 per



participant per year—and patients were healthier.

A 2005 study estimated that every dollar spent on such medication-adherence programs can save $7 for patients with diabetes, $5 for those with high cholesterol, and $4 for high blood pressure. It's "one of the best ways to improve care ... and get more out of each health-care dollar," says Dr. John O'Brien, an assistant professor at the College of Notre Dame School of Pharmacy in Maryland. Consequently, the National Consumers League is planning a major campaign next year to persuade the public to take their pills.



7 DISCUSS OPTIONS NEAR THE END OF LIFE

One-quarter of Medicare dollars are spent in the last year of patients' lives. The costs of end-of-life care vary wildly, however. The Dartmouth Institute for Health Policy has found that spending is nearly three times higher in Manhattan than in areas of Colorado, mainly because patients in Manhattan average 21.9 days in the hospital during their last six months, compared with only 6.3 days in Grand Junction, Colo. Yet higher costs don't translate to longer or better lives.

Aetna discovered that high-quality care for the dying actually lowers costs. The insurer started its Compassionate Care program in 2004 to educate terminally ill patients and their families about treatments, living wills, and hospice care. "It was about dignity, not cost control," says Dr. John W. Rowe, former CEO of Aetna. Instead of unneeded tests and futile treatments, patients got more nursing care, pain management, and psychological support, says Rowe, now a Columbia University professor.

Program participants were twice as likely as average patients to choose hospice care. Costs came down 20%, yet surveys showed that both patients and their families were more satisfied than those not in the program. Such counseling efforts "are not about 'death panels,'" says Dr. Elliott S. Fisher, a professor at Dartmouth Medical School. "This is about better care, aligned with what patients want."

$100-150 billion

Sum lost each year to administrative inefficiency—the most troubling example being vast amounts of often unnecessary paperwork

Data: Thomson Reuters

8 USE INSURANCE TO MANAGE CHRONIC DISEASE

In 2009, UnitedHealthcare introduced the Diabetes Health Plan, a new type of benefit that offers financial rewards to patients who manage their disease properly. Three companies, including General Electric, are testing the plan, and 15 more workplaces signed on to roll it out in 2010. Employees who participate in the UnitedHealthcare plan must adhere to specific treatment guidelines and agree to be tracked by the insurer to make certain they are sticking with the program. In return, co-pays on their diabetes drugs are waived, along with other fees related to managing their disease.

The United plan is part of a larger trend in managed care called "value-based insurance design." The idea is to contain costs by giving financial incentives to patients based on their particular health issues rather than offering one-size-fits-all plans. "One issue in the health-reform debate is that we're paying an awful lot for health care and yet we don't have the healthiest outcomes," says Dr. Edmund J. Pezalla, national medical director for pharmacy management at Aetna, which is also experimenting with value-based insurance design. "There are things providers and patients can do together to achieve better outcomes."

The impact of tailoring plans to employees with specific diseases could be significant. United estimates that diabetes costs the health-care system $174 billion a year.

$25-50 billion

Amount wasted every year on treatments for preventable conditions, which range from diabetes to certain forms of heart disease

Data: Thomson Reuters

9 LET WELL-INFORMED PATIENTS DECIDE

When Floyd "Jack" Fowler Jr. holds focus groups of heart patients, he's amazed at their misplaced faith in the benefits of medical procedures. "They all think they'll die if they don't have bypass surgery or angioplasty," says Fowler—even though studies show that both procedures extend lives or prevent heart attacks in only a tiny minority of especially sick patients. But hardly anyone knows this, he says.

Fowler's nonprofit Foundation for Informed Medical Decision Making has sought for years to give patients both that knowledge—and a choice. The idea is to explain thoroughly to people the benefits and risks of medical procedures they may be facing. At the Spine Center at Dartmouth-Hitchcock Medical Center, for example, patients with back problems are shown a video that walks them through various procedures and provides data showing that outcomes are similar whether or not they have surgery. Once the program started, spinal surgery rates dropped 30%.

So far, shared decision-making efforts reach only a small number of patients. But given that as much as 37% of health spending is wasted on unnecessary care, the idea is catching on. Washington State passed the nation's first law two years ago encouraging informed decision-making, and other states are expected to follow, says Dr. Lance Lang, senior medical director at Health Dialog.

$75-100 billion

What is wasted annually treating provider errors, many of them adverse drug reactions or injuries caused by medical procedures

Data: Thomson Reuters



10 APOLOGIZE TO THE PATIENT

Doctors regularly complain that fear of malpractice suits forces them to order far more tests and procedures than necessary. Although President Obama has said he is open to legislation that would limit malpractice awards, there may be a simpler solution. Sometimes all it takes is an apology.

The Sorry Works! Coalition, founded in 2005, is persuading hospitals to disclose mistakes to patients and their families. Under the policy, as soon as a hospital discovers an error, the patient is informed, the cause is investigated, and changes in procedure are recommended. If the provider is at fault, the patient is offered a settlement.

The University of Michigan Health System adopted the policy in 2001 and reports that malpractice claims fell from 121 a year to 61 in 2006. The honesty "takes away some of the anger of patients and the 'gotcha' of plaintiff lawyers," says Douglas B. Wojcieszak, who founded Sorry Works! after losing his brother to a medical error. "You don't need any legislation, judge, or politician to do this—it's simply customer service." The University of Illinois Medical Center in Chicago started a formal apology program in 2006 and says the number of claims has since declined 40%, despite a 20% increase in clinical activity.

—With Esmé E. Deprez, John Carey, and Arlene Weintraub

TAIWAN'S NEW DREAMS

As PC sales decline, the island's top tech players are shifting out of low-margin businesses and into smartphones, solar-power chips, and beyond

By Bruce Einhorn
Photography by Paul Hu

At the depth of the global economic crisis, Taiwan Semiconductor Manufacturing Co. was in trouble. With factories operating at just a fraction of capacity, Morris Chang—TSMC's silver-haired founder—laid off hundreds of staffers, ordered the remaining workers to take unpaid leave, and took other cost-cutting steps such as dimming the lights in hallways. "It was terrible," Chang says in his office on the eighth floor of "Fab 12," a vast facility that serves as TSMC's headquarters.

These days, things look far better. TSMC's plants are humming again, and its Taipei-listed shares are up 41% this year. But Chang is chastened. The era of easy double-digit growth for chipmakers "isn't there anymore," he says, taking a puff on his ever-present pipe. "We need to find new areas." TSMC is stuck in a maturing industry, and its primary business of making chips for other companies is likely to grow just 8% annually in coming years. So Chang wants to boost TSMC's presence in solar power and light-emitting diodes (LEDs). The two have technological overlap with chip production, but they offer far better margins and more potential. "They are going to be fast-growth industries," Chang says.

Executives across Taiwan's tech industry are making similar strategic shifts. Shi-Wei Sun, chief at chipmaker United Microelectronics, in August launched a division focusing on solar and LEDs. Peter Chou, CEO of smartphone maker HTC, is reducing his company's reliance on Microsoft Windows-based handsets, adding more phones using Google's Android operating system. And Au Optronics is plotting a move beyond its traditional LCD displays, which require investments of billions of dollars every few years for companies to stay ahead of rivals. "Coming out of the recession, AUO is a completely different company," says C.T. Liu, chief of AUO's consumer display business. First up, he says, will be e-readers and electronic paper, newfangled displays that can be rolled or folded. Both technol-



Chou's HTC is now switching to Android handsets

ASSIGNMENT ASIA





Wistron's Lin aims to build a $1 billion business in tech recycling

ogies will let AUO capitalize on its display-making expertise.

Why the urgent shifts? While Taiwan plays a vital role in the global tech industry, it is strongest in low-margin businesses such as PCs and components. That has created a dead end for many manufacturers, which face constant pressure from Hewlett-Packard, Dell, Sony, and other big customers to cut prices. "The business model is kind of hitting the wall," says Bill Wiseman, a partner with McKinsey in Taipei. So companies are preparing for the post-PC era by diversifying into other, more mobile devices and building up their own brands.

True, things aren't exactly dire for the island's tech titans. The Taiwanese benchmark index of electronics stocks is up 76% and, thanks largely to strong demand from China, orders keep coming for more chips, PCs, and other devices. Taipei has become one of Asia's most livable cities: With so much of its heavy industry now on the mainland, the air is much cleaner than in years past. And with relations between Beijing and Taipei on the mend, increasing travel and trade between the two sides will speed integration and further lift the Taiwanese economy. Taipei's Songshan Airport, for decades a sleepy terminal for short hops across the island, now buzzes as the hub of direct flights to mainland cities. Chinese authorities "are much friendlier" toward Taiwanese, says HTC Chairman Cher Wang, who recently jumped on a plane in Chengdu at noon and was back in Taipei by 3 p.m. "They feel that we're brothers who used to have a dispute but now are settling," she says.

Still, as last year proved, things can turn south quickly, something many Taiwanese tech companies fully understand. So Acer, which last summer passed Dell to become the world's No. 2 PC company (behind Hewlett-Packard), is moving into products such as smartphones and other mobile devices. Vizio, produced by Amtran Technology—a 15-year-old company that got its start making PC monitors—is now a top-selling brand of flat-screen TVs in the U.S. And notebook maker Quanta Computer is mulling production of devices such as cameras, gaming machines, and medical sensors. "Quanta will become a brand new company from now on," vows Chairman Barry Lam.

Taiwanese companies seeking to diversify might want to follow Simon Lin's lead. He is CEO of Wistron, the manufacturing arm of Acer that was spun off in 2002 when Acer decided there was no glory in being a contract manufacturer. Wistron still shares with Acer a drab office tower in the low-rent Taipei suburb of Hsichih. The neighborhood is no match for Hsinchu, the giant tech park where TSMC has its digs, but it fits with Wistron's low-key, low-cost image. The company, which had revenue of $13.5 billion last year, has already expanded far beyond PCs, making TVs and BlackBerry smartphones.

More ambitious diversification is coming soon. Lin, fresh from a Taipei meeting with Microsoft CEO Steve Ballmer, says the devices Wistron makes in the years ahead will have to connect to the Internet but won't necessarily be computers. Lin also wants Wistron to develop businesses such as equipment repair and recycling, which is sure to pick up as more governments mandate clean disposal of old tech gear. To that end, Wistron in October invested $8 million in a company that recycles computer motherboards. Within a few years, Lin predicts, Wistron could have a $1 billion business in tech recycling. "No one has a crystal ball to say how long [the PC business] will last," he says. "But we are not sitting here just waiting for the sunset of the PC industry."

HOW TO PLAY IT 070

While PCs may rebound next year as the economy picks up and companies upgrade to Windows 7, they will surely be a smaller part of the tech mix as the market shifts. And the island's electronics makers will thrive in that post-PC era, says Jen-Hsun Huang, CEO of chipmaker Nvidia, who grew up in Taiwan before moving to the U.S. "If every cell phone in the world becomes a mobile computer, if every TV becomes a connected TV," he says, "holy cow!" |BW|

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Warming Trend

While Beijing has long welcomed Taiwanese investment in many industries, Taipei did not reciprocate until this year. Since new regulations took effect on June 30, Taiwan's economics ministry has tallied $5.9 million worth of Chinese direct investment, Taiwan's Central News Agency reports. And that trickle may build to a steady flow if Taipei broadens the list of areas, including parts of tech, in which Chinese companies are welcome to invest.



To learn more about cross-straits investment, go to **http://bx.businessweek.com/china-business/reference/**

Top 20 Taiwan Global Brands 2009

With Asia and the world still reeling from the after-shocks of last year's financial meltdown, Taiwan's top 20 global brands have actually performed far better than expected. What more fitting tribute to Taiwanese brand owners' commitment to quality.

"In the face of global economic turmoil, Taiwan's top brands have proven themselves to be astonishingly resilient", says Stuart Green, Asia Pacific President of Interbrand, the leading global brand experts behind the study. "While these brands' overall aggregate value did fall 2.5 percent over 2008, this figure compares very favorably against a decline of fully 34 percent in the NYSE Composite Index during the same period", he added.

Collaborating with the Taiwan External Trade Development Council and BusinessNext magazine, Interbrand leveraged core elements of its proprietary judging system to establish this year's top 20 Taiwanese brands. To qualify, brand owners had to be publicly listed and earn at least one-third of their brand revenues outside Taiwan (20 percent of each companies' revenues had to be generated by its own brand and originate in Taiwan, or be owned by a listed Taiwanese company).

Interbrand's judges used three criteria in evaluating Taiwan's top 20 brands in 2009. One: a financial analysis forecast of the percentage each brand would contribute to its company's revenues for the next five years. Two: a demand analysis of each brand's awareness in the minds of consumers. And Three: an analysis of each brand's strength in terms of risks versus earnings forecasts. After careful deliberation, each brand was assigned the "net present value" which Interbrand believes "comes closest to representing a brand's true economic worth".

So here are Taiwan's top 20 global brands for 2009. We are sure you will agree with Interbrand's Green when he states: "With B2B and B2C customers wanting maximum value for their hard-earned money, trust, transparency and reputation ensure Taiwanese brands remain ideally positioned to capitalize on opportunities in lucrative overseas markets".

Rank 2009	Company Name and Logo	2009 Brand Value (US$ millions)	Description
1	Acer	1241	Acer's No. 1 ranking vindicates founder, Stan Shih's belief in strongly branding his company's best-selling PCs and notebooks.
2	TrendMicro	1235	A newly launched Smart Protection Network underlined Trend Micro's position as a global leader in cloud-client Web threat protection techhology.
3	ASUS	1226	Committed to "Inspiring Innovation and Persistent Perfection", ASUS PCs continue to set computing benchmarks for affordability, portability and style.
4	HTC	1203	An innovation and design contender, HTC was first to launch a mobile phone based on the Android platform and sold 2 million units worldwide of HTC Diamond within six months of launch.
5	MasterKong	916	Steady investment in distribution channels helped MasterKong's noodles, ready-to-drink teas and bottled waters to enjoy "Better Access, Broader Reach" across China.
6	Want-Want	421	The world's largest rice cracker manufacturer, Want Want's unique packaging and strong China focus perfectly embody its spirit of "Fate, Confidence and Unison".
7	Maxxis	345	Backed by 17 years' experience of engaging consumers, Maxxis's tires continued to occupy the sales fast lane in Mainland China.
8	Giant	262	Trailblazing initiatives such as the "Giant Store Inside" and new women's Liv/giant bicycles enabled Giant to cement its global market share.
9	Synnex	255	2009 saw Synnex maintain its successful philosophy of providing integrated value-added logistics services that grow with end-users' needs.
10	ZyXEL	222	Known around the world for its customer-centric internet connectivity devices, ZyXEL celebrated its 20th anniversary by continuing to "Unleash Networking Power".
11	Transcend	212	A strongly customer-focused company, Transcend continues to "Exceed Expectations" by extending its top performing electronics products into the 'own brand' and retail arenas.
12	Advantech	204	By focusing on empowering small- to mid-sized projects, Advantech has become the world's second largest industrial pc (IPC) supplier.
13	D-Link	190	D-Link's cutting edge application- and service-driven network connectivity solutions remain the standard for design, development and manufacturing excellence in 64 countries worldwide.
14	Uni-President	173	Initiatives such as sponsorship of Beijing 2008 guaranteed Uni-President's range of noodles, yoghurts and tea drinks remained "Everyone's Favorite Symphony of Food".
15	Johnson	159	New products such as the Kyoyama massage chair ensured Johnson's high-end fitness equipment maintained healthy sales in 60 countries worldwide.
16	Merida	152	Made "By Bikers For Bikers", Merida has successfully added high-end bicycles such as the top quality Ninety-Six design to its mass-market range.
17	CyberLink	93	The hugely successful launch of the award-winning PowerDVD 9 software is yet another example of CyberLink's enormously innovative, user-focused software solutions.
18	Genius	69	New products such as a pioneering Optical Touch Controller ensure Genius continues to inspire users to "Live with Ideas" in the world's most lucrative emerging markets.
19	Depo	49	Renowned for providing high quality after market autolamps, Depo now generates 60 percent of its sales in North America and Europe.
20	MSI	47	An increased emphasis on thin, light netbooks and car infotainment saw MSI take encouraging strides forward in globalizing and diversifying its business.


North America and Europe deployed more virtual than physical servers in 2008.
95% of data centers are deploying virtualization
TECHNOLOGY
Gartner VP Neil MacDonald: Virtualization will be the target of new security threats**
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*Per Gartner Group Vice President Neil MacDonald, as quoted in: McLaughlin, Laurianne; "How to Find and Fix 10 Real Security Threats on Your Virtual Servers," CIO Magazine, 14 November 2007, www.cio.com/article/print/154950
**Per Gartner Group Vice President Neil MacDonald, as quoted in: "Gartner: Rush to Virtualization Can Weaken Security," On-Demand Enterprise, 09 April 2007,
http://www.on-demandenterprise.com/offthewire/gartner_rush_to_virtualization_can_weaken_security_07-29-2008_08_52_18.html


88% of North American companies don't have a virtualization security strategy
60% OF PRODUCTION VIRTUAL MACHINES
ARE LESS SECURE THAN THEIR PHYSICAL COUNTERPARTS.*
THINK CONVENTIONAL SECURITY CAN PROTECT YOUR VIRTUAL ENVIRONMENT?
THINK AGAIN.
Enterprises around the world are relying on virtualization to increase data center efficiency and, unknowingly, leaving themselves more vulnerable. That's because conventional security isn't able to protect virtual machines or see the traffic between them – leaving data and networks exposed. Which is why, according to Gartner Group, in 2009 sixty percent of virtual machines are less secure than their physical counterparts. But with Trend Micro™ Enterprise Security, powered by the Trend Micro™ Smart Protection Network™ infrastructure, you can mitigate the risk and maximize the benefits of virtualization. It's a different kind of security that protects your physical and virtualized environments and helps set the foundation for your company to move confidently into the cloud.
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FERTILE GROUND FOR STARTUPS

By Spencer E. Ante
Photograph by Timothy Archibald

History shows that a certain breed of entrepreneur feeds off adverse conditions, and this recession is no exception

Who needs job security? In June 2008, as the recession was moving from bad to worse, Caterina Fake gave up a comfortable, executive-level job at Yahoo! to launch a company. She left California and set up shop in New York City to co-found Hunch, a Web site that uses the experiences of others to help people make decisions. The 40-year-old, who had co-founded the photo-sharing site Flickr before it was acquired by Yahoo, couldn't resist the idea of creating something new, whatever the economic headwinds. "The entrepreneurial spirit really thrives in situations of adversity," says Fake. "The world is full of more possibility."

Fake isn't alone in betting on that. A crop of potentially groundbreaking companies is emerging from the wreckage of the Great Recession. No question, some will blow up, and others will fail to reach their potential. But the downturn has done little to dampen the entrepreneurial spirit. During the first half of this year, angel investors financed 24,500 new ventures, 6% more than during the same period last year, according to the Center for Venture Research. The overall amount of money going into startups has declined, but the figures suggest that this year will see the birth of roughly 50,000 companies with enough promise that someone is betting money on them. "It may be that this is the best time to start a company," says Carl Schramm, president of the Kauffman Foundation, an organization that promotes entrepreneurship.

"VAST AND UNTAPPED"

With that backdrop, *BusinessWeek* set out to find the world's most intriguing new companies. After much reporting and research, we've assembled a list that's a barometer of innovation trends in the global economy, with startups that are pioneering new markets in biotechnology, clean technology, health care, and Web computing. Hunch is just one of 25 that made the final cut. Other standouts include Epizyme, a Massachusetts outfit creating cancer-fighting drugs that attack errant proteins; China Water & Energy, a Hong Kong company developing massive wind-power farms in the Chinese countryside; and Driptech, a California startup engineering low-cost irrigation systems for poor farmers around the world. "The markets that we are addressing in India and China are vast and untapped," says Driptech's 26-year-old founder, Peter Frykman.

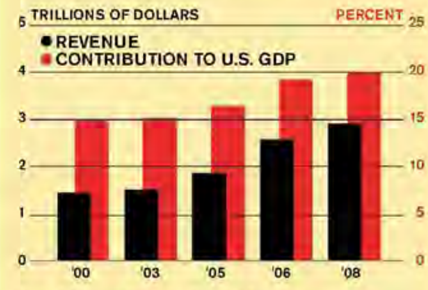
History shows that great companies are often built dur-



Driptech's Frykman aims to deliver consistent irrigation where it has been scarce

BUSINESS ENGINES

The economic benefit of U.S. venture-backed companies



Data: National Venture Capital Assn., U.S. Commerce Dept.

ing bad times. In 1939, at the tail end of the Great Depression, two engineers started Hewlett-Packard in a garage in Northern California. Silicon Valley itself was largely created during the nasty recession of the mid-1970s. During that decade, entrepreneurs laid the groundwork for the boom of the 1980s, building companies that pioneered three new industries: Atari in the video game business, Apple in personal computers, and Genentech in biotechnology. "The only people who venture out in tough times are on a mission, which is what you need," says Michael Moritz, managing partner of Sequoia Capital, a venture capital firm that invested in Apple back in the '70s. "The people we are meeting are the genuine article, as opposed to the pretenders."

Entrepreneurs, financiers, and historians point to several other reasons for this phenomenon. For starters, everything is cheaper during a downturn, including the cost of labor, materials, and office space. There's less competition both from incumbents preoccupied with putting out their own fires or from other startups unable to raise money. Tighter money means stronger ideas edge out weaker ones. And the tough times force entrepreneurs to work on their business models earlier, so they end up reaching profitability more quickly than when money comes cheap. "[The years] 2010 and 2011 should be extremely good years for innovative small companies," says Jim Breyer, general partner of Accel Partners, a venture capital firm that has invested in Facebook. "We'll see dozens of very successful companies emerge."

SMALL DROPS, BIG SPLASH

Startups are playing an increasingly important role in American business, and they may play a central role in any recovery. As of the end of 2008, companies infused with venture capital were responsible for generating 12 million jobs and 20% of U.S. gross domestic product, according to a recent survey published by the National Venture Capital Assn. A previous NVCA survey found that venture-backed companies accounted for 10 million jobs and nearly 17% of GDP at the end of 2005.

Entrepreneurship is also becoming more global. China and India are leading the way, but Tarun Khanna, a Harvard Business School professor, sees pockets of innovation popping up in less obvious places, such as Brazil, South Korea, and Turkey; 5 of the 25 companies on *BusinessWeek*'s list are based outside the U.S. "Now you are seeing traction in a handful of countries," says Khanna.

Still, recessions certainly present challenges for entrepreneurs. It's much harder to drum up business, take a company public, or raise money than during good times. In the third quarter of 2009, venture capitalists invested $4.8 billion in 637 companies, down from $7.2 billion and 994 companies in the year-earlier quarter, according to a report from PricewaterhouseCoopers and the NVCA.

Fake has some experience working her way through tough times. When she co-founded Flickr after the tech bust, Internet startups were shunned and the company couldn't raise capital from professional investors. So Fake hit up friends and family for money and scraped her way along until the company had built a popular photo-sharing site that foreshadowed the rise of Facebook and other social media Web sites.

Today, Fake is back to being careful with her cash. Last September, to stretch her bankroll, the company lowered salaries for all 10 employees. The group hasn't scaled back its ambitions, though. They believe Hunch can be a leader in a new kind of search technology, going beyond Google to deliver answers based on the wisdom of crowds. Type in "What magazine should I subscribe to?" for example, and Hunch will provide answers by matching responses from users with similar preferences. "The next phase in search is some mating of brute-force algorithms and user-generated content," says Fake.

So far, Hunch has built up to about 300,000 users and has been gathering information about those people by asking them 5 to 10 questions. Now Fake is preparing to move out of "learning mode" with a home page that doesn't require people to fill out a questionnaire. "It is actually time to expand and spend and start a new project," says Fake. "We love recessions." |BW|

METHODOLOGY

How do you judge the world's most intriguing companies? There's no clear formula, of course. Still, we tried to bring rigor to the process. After debating the priority of various characteristics, we agreed the most important was having big ideas. Intriguing companies need to have a grand vision that forces you to consider how industries, economies, or the world could be remade. But we didn't want only dreamers. So to qualify, entrepreneurs had to have established a company and gotten some traction. To get the freshest ideas, we limited selection to companies less than three years old and eliminated familiar names.

Then we cast a wide net. Our call for entries over the Web generated hundreds of submissions. To complement the public's input, we reached out to startup advocates, including the Kauffman Foundation, National Venture Capital Assn., and YouNoodle, a Web startup with a database of 50,000 companies. We then used an algorithm developed with YouNoodle that gauged the originality of each company and its progress so far. Disagree with the final 25? Did we leave an important startup out? Let us know in the reader comments section at businessweek.com.

COMPANY NAME	LOCATION	FUNDING TO DATE	INVESTORS	WHY THEY'RE INTRIGUING
Aspiring Minds	Gurgaon, India	$500,000	Ajit Khimji Group	Co-founded by an MIT grad, this Indian startup has developed computer-based testing software to help companies cheaply evaluate and train workers.
BioFuelBox	San Jose, Calif.	9,500,000	Draper Fisher Jurvetson	BioFuelBox converts grease and fat from food waste into biodiesel. Its first plant converts waste from potato processing facilities in Idaho.
BrightSource Energy	Oakland, Calif.	160,000,000	VantagePoint Venture Partners	One of the world's leading developers of solar thermal technology, BrightSource won the contract for an enormous solar project in California's Mojave desert.
Bump Technologies	Mountain View, Calif.	3,020,000	Y Combinator, Ron Conway, Sequoia	One of the hottest free iPhone apps, the company's software lets users share personal contact information and photos simply by bumping two phones together.
China Water & Energy	Hong Kong	6,000,000	Family of Adrian Ho	This company is trying to use its founders' connections with Chinese officials to get a leg up in the burgeoning market for wind power on the mainland.
CitySourced	Los Angeles	65,000	Dale Okuno	CitySourced's iPhone application lets people snap pictures of potholes, graffiti, and other annoyances and send them directly to the right person at City Hall.
Coulomb Technologies	Campbell, Calif.	3,750,000	Estag Capital	Electric car drivers in San Francisco and Europe can plug in at Coulomb's charging stations, which are about the size of a parking meter.
Driptech	Palo Alto, Calif.	100,000	Scott Petry, Project Redwood	Driptech's low-cost irrigation technology is designed to help millions of poor farmers in the developing world struggling with water scarcity.
Epizyme	Cambridge, Mass.	46,000,000	Kleiner Perkins Caufield & Byers	Epizyme's drugs attack cancer-causing enzymes. The company has attracted major funding from venture firms and drugmakers Astellas and Amgen.
Fitbit	San Francisco	2,050,000	SoftTech VC, True Ventures	The startup sells a $99 gizmo that tracks movement, exercise, and sleeping patterns. The data zips wirelessly to a Web site, where you can chart your progress.
Freedom Meditech	La Jolla, Calif.	630,000	JumpStart Ventures, Catherine Stiefel	With just one employee, Freedom Meditech is as small as can be. But CEO Craig Misrach aims to upend the $10 billion global diabetes monitoring market.
FreeWheel	San Mateo, Calif.	14,750,000	Foundation Capital, Battery Ventures	Hatched by former DoubleClick execs, this new service helps big media companies such as Warner Music manage and monetize ads for online videos.
Genocea Biosciences	Cambridge, Mass.	23,000,000	SR One, Polaris Ventures	Using a technology developed at Harvard Medical School, Genocea can rapidly test experimental vaccines in a simulated version of the human immune system.
Hunch	New York	2,000,000	General Catalyst Partners, Bessemer	Launched by Flickr co-founder Caterina Fake, Hunch helps answer questions by matching responses from users who share similar preferences.
Justin.tv	San Francisco	6,200,000	Y Combinator, Alsop-Louie	Justin Kan launched the site as a live video "lifecast" of himself. Now it is one of the largest live video-sharing communities, with 40 million monthly visitors.
Layar	Amsterdam	1,000,000	Sunstone Capital	Layar has created free software that lets smartphones deliver "augmented reality"—text and images laid over scenes viewed through a device's camera.
Patients Know Best	Cambridge, Britain	75,000	Seedcamp	Harnessing the Web to improve health care, this service lets doctors and patients communicate online. It won a contract with Britain's National Health Service.
Permuto	Palo Alto	6,030,000	Onset Ventures, Rembrandt Venture	The startup aims to bring the precision targeting of search advertising to display ads, by tracking consumers' online shopping behavior.
Phycal	Highland Heights, Ohio	15,000,000	U.S. Defense Dept., angel investors	Is there gold in pond scum? By harvesting oil from living algae, Phycal aims to undercut diesel and jet fuel with a homegrown, eco-friendly replacement.
Scribd	San Francisco	12,800,000	Charles River Ventures, Redpoint	A sort of YouTube for publishing, Scribd lets 40 million users upload digital versions of reports and other printed matter and share them easily across the Web.
Sense Networks	New York	9,000,000	Intel Capital, Javelin Venture Partners	This technology, which crunches real-time, location-based data from wireless carriers and cars, can be used to craft next-gen marketing and ad campaigns.
SolarCity	Foster City, Calif.	56,000,000	First Solar, Draper Fisher Jurvetson	The largest provider of residential solar systems in California, SolarCity provides financing, installation, and monitoring services for homeowners and companies.
Spotify	London	82,000,000	Northzone Ventures, Li Ka Shing	A legal peer-to-peer music streaming service, Spotify serves up nearly any song you want to hear. Only available in Europe but coming to the U.S. soon.
Xobni	San Francisco	15,100,000	Atomico Investments, Khosla	Can't stay on top of your e-mail? Xobni overhauls Microsoft Outlook to make all that information more searchable and easy to organize.
Zynga	San Francisco	39,000,000	Clarium Capital, Foundry Group	Social game juggernaut Zynga is riding high on the sales of virtual goods, such as the digital crops purchased by players of the popular game FarmVille.

Data: Companies, YouNoodle

CHINA WATER & ENERGY

REAPING THE WIND

This clean-energy startup is positioned to profit from China's plans to go green

As Chinese cities have become increasingly polluted, the government has laid out ambitious plans to lessen dependence on fossil fuels. By 2020, Beijing aims to have 15% of the nation's electricity come from wind, solar, or other renewable sources. Adrian Ho sees that as a tantalizing opportunity for startups like his China Water & Energy, which builds and operates wind farms for power companies. These startups have the chance to grow into major businesses while helping the most polluting country clean up its act. "There are opportunities for almost anyone who has access into the game," he says.

Getting in the door is the trick, though, and that's where Ho figures Hong Kong-based CWE has an edge. In a country where *guanxi*, or connections, remain an important part of doing business, the 32-year-old former investment banker comes from a prominent southern China family. His grandfather, Ho Tim, co-founded Hang Seng Bank, one of the largest in Hong Kong, and an uncle, Edmund Ho, became the first chief executive of Macao in 1999 after the former Portuguese colony returned to Chinese rule.

Now, as chairman and chief executive officer of CWE, Ho is putting those connections to work. Family members provided some of the $6 million in angel-round funding for CWE last year, and he is using the family name to make inroads with the government-run companies that operate China's power grid. Steve Lyons, general counsel at CWE, recalls one meeting with local officials in Inner Mongolia. Negotiations over a partnership were tense until Lyons reminded the officials of CWE's ties to the Ho family. "Their eyes lit up," says Lyons. "We were able to solve [the problems] primarily on that."



Ho's prestigious family ties are helping lubricate deals with municipalities

PAUL HU/ASSIGNMENT ASIA

INDUSTRY KNOWHOW

Family *guanxi* aren't CWE's only kind of connection. When Ho decided to focus on wind energy he recruited Jim Crabtree and Jim Morris, two former General Electric Capital vice-presidents. GE is one of the world's top producers of wind turbines and also invests in wind farms. But since Beijing requires 51% Chinese ownership of renewable-energy projects to qualify for carbon credits, GE must partner with power companies or operators like CWE. Ho believes he can help match GE with those Chinese power producers.

CWE's biggest deal so far is a joint venture with a subsidiary of China Guodian, one of the five largest electricity producers in China. CWE expects to invest about $80 million initially, with the first phase of the project going online in early 2011. The company says it has nearly sealed a deal to co-develop an $88 million wind farm in Jilin that will begin operations next year.

Many outfits are trying to get a piece of the $16 billion Chinese power companies are expected to spend on wind projects over the next decade. Jonathan Woetzel, a McKinsey partner in Shanghai, believes companies focusing on wind-farm design and management are well-positioned. "The big opportunity to improve wind is around operations," he says. That suggests CWE, with both *guanxi* and industry expertise, has a good shot at success.

–Bruce Einhorn, with Frederik Balfour

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(1), (2): Based on data provided by a major server storage company using an HDD-only system and SSD applied systems.
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SAMSUNG

LAYAR

AUGMENTING REALITY

Software from Layar blends digital data with the physical world. Just point your cell phone

Take a stroll through the Plaza San José in San Juan, Puerto Rico, and you'll see on one side of the square the Museo Pablo Casals, dedicated to the famous Spanish cellist. Point a specially equipped mobile phone at the elegant 18th-century building and you'll notice more than the museum. On the device's screen, you can see data on admission prices and video clips of Casals superimposed on the real-world scene.

This view may offer a glimpse into the future. Tech companies are working furiously on what they call augmented reality, or methods of blending digital data with the physical world. They're finding that mobile phones, as they become increasingly capable, may be the ideal device for bridging the gap. "[Augmented reality] will prove to have far-reaching impact," says John Hagel, co-chairman of Deloitte's innovation research center. "It's a tool for navigating cities or learning about services that aren't visible."

The technology in Puerto Rico comes from a Dutch startup called Layar. The company makes free software that any developer can use to associate digital information with a specific location, from the Great Wall in China to the local Wal-Mart. Any phone with Layar software, including Apple's iPhone and handsets running the Android operating system, will show the information onscreen at no cost. Layar makes its money by charging developers to advertise their apps on the phone's screen.

Researchers at Nokia, IBM, and Microsoft are experimenting with augmented reality, too, but Layar has beaten them to a commercial program. In June, Dutch bank ING launched a Layar app to steer customers to ATMs in Amsterdam. Aim phones in any direction, and onscreen circles pop up referring to nearby ING branches. Among Layar's 213 other applications is a guide to McDonald's restaurants in Hong Kong.

ENDLESS BILLBOARD

Co-founders Claire Boonstra, Maarten Lens-FitzGerald, and Raimo van der Klein founded Layar eight months ago and are closing a $1 million financing round led by Copenhagen's Sunstone Capital. Lens-FitzGerald says the 10-person company is already profitable.

This month, Layar will unveil a new feature that allows developers to create three-dimensional virtual objects Layar users will see through their phone's screen. It's a bit like limitless billboard space for techies. "There's a completely new industry being created," says Boonstra. "We want to bring our own vision to that." *—Reena Jana*



Boonstra and Lens-FitzGerald in Amsterdam: Uniting real and unreal estate



ROBERTO FRANKENBERG

EPIZYME

BIOTECH TAKES ON CANCER

Epizyme scientists are designing drugs to fight it at the genetic level

When Kazumi Shiosaki is explaining the science behind her biotech startup, Epizyme, to investors, she uses a piano analogy. The keys, she says, are like genes: They're silent until fingers on the keyboard pick out a tune. Genes, of course, determine how our bodies change over time. But they only spring into action when prompted by another set of biochemical factors—separate from DNA—known as the epigenome. Epizyme scientists believe they may be able to control disease-related genes by aiming new drugs at these factors.

The science of epigenetics is highly complex, but investors seem to get



Shiosaki believes drugs can be employed to control disease-related genes

SHAWN G. HENRY

the picture. On Oct. 7, privately held Epizyme, based in Cambridge, Mass., announced that it had raised $32 million from a diverse group, including the venture-investing units of biotech giant Amgen and Japanese drugmaker Astellas Pharma. It was an impressive feat in a market that's hostile to biotech startups. The amount of venture capital raised by biotechs in the third quarter of 2009 dropped 30% year-over-year, to $759 million, according to San Francisco financial-services firm Burrill & Co.

"NEW BIOLOGICAL PLATFORM"

Epizyme is in the spotlight mainly for its promising research on cancer. Its insights stem from an understanding of how DNA wraps around proteins that control how genes create cells, tissues, and organs. Its new drugs are designed to cripple enzymes that go awry in this process, contributing to cancers of the lung, breast, prostate, and more. Someday they might be tested against Alzheimer's disease, inflammation, and obesity as well. "We believe epigenetic targets present a fundamental new biological platform that will allow us to get into [such] indications," says Shiosaki, Epizyme's CEO and a managing director for its lead investor, MPM Capital.

Epizyme faces a daunting hurdle: It must prove that its drugs can hit their exotic targets without harming healthy tissue. "Some epigenetic changes are supposed to be there—they support life," says Susan K. Murphy, assistant professor at Duke University Medical Center.

Shiosaki's background prepared her for such challenges. A PhD chemist, she began her career in drug discovery at Abbott Laboratories and Millennium Pharmaceuticals before moving to MPM Capital. In 2007 she organized an academic presentation on emerging cancer research and realized the field of epigenetics had come of age. MPM formed Epizyme under Shiosaki's command, and she recruited a slate of other drug-industry veterans, including chief scientific officer Robert A. Copeland, who came from GlaxoSmithKline. The team impressed Shinya Yano, CEO of investor Astellas Venture Management. Though it's still early days, he says, "Epizyme has a lot of talented scientists." *–Arlene Weintraub*

DRIPTECH

A BIG IDEA FOR LITTLE FARMS

Affordable, efficient irrigation equipment that could change the economics of food

In the countryside of Shanxi Province in north-central China, farmer Xie Xin has struggled for years with water shortages. The 47-year-old, who grows tomatoes and cucumbers, had to pay dearly to use the local well, since the region receives an average of only 16.5 inches of rainfall annually. But this year, Xie started participating in an experiment in which farmers use new irrigation equipment to conserve water. The equipment, similar to a garden hose with small holes every foot or so, is expected to cut his water use by more than half. Through a translator, Xie says he'll save money and boost production by reducing water-related diseases.

The gear Xie uses comes from a startup in Palo Alto, Calif., called Driptech. Although similar kinds of irrigation systems have been used for decades, Driptech is winning business in places such as rural China because its technology is designed specifically for small farms and costs much less than traditional systems. The company's equipment runs $300 for a one-acre farm, instead of the usual thousands, and as little as $5 for smaller family plots. "There are literally hundreds of millions of small-plot farmers suffering from seasonal water scarcity," says Peter Frykman, Driptech's 26-year-old founder. "We're focused on reaching our first million farms as fast as possible."

Experts say low-cost irrigation could alter the economics of food. Subsistence farmers may be able to grow excess crops they can sell. Countries that rely on food imports could see their dependence on outsiders decline. "[These] modern irrigation technologies are the future

for water-scarce areas," says Claudia Ringler, a senior research fellow at the International Food Policy Research Institute, a Washington (D.C.) think tank.

The idea for Driptech grew out of a project Frykman worked on last year at Stanford University, where he completed his bachelor's and master's in mechanical engineering. He was looking into drip irrigation, the technique of using hoses and nozzles to drip water only where plants need it, which has spread widely since it took off in Israel in the 1970s. Frykman's breakthrough was the realization that such systems didn't have to be made in large manufacturing facilities and then exported abroad. Instead, they could be made with cheap plastic tubing and compact precision lasers, even in facilities in target markets.

PRO-PROFIT, PRO-FOOD

Frykman founded the company last June with $5,000 of his own money and set up manufacturing in the second bedroom of his Palo Alto home. The company gradually attracted about $100,000 in grants, donations, and investment, and he moved into an office. "I was drawn to Driptech because, frankly, their success means people are growing food," says Scott Petry, founder of e-mail software provider Postini, who invested $40,000. "I'm not looking for monetary rewards."

Driptech is a for-profit company, and Frykman sees plenty of financial opportunity. His goal is to set up local manufacturing operations so he can lower costs and get the company to profitability. He figures that for $50,000, Driptech can set up a facility that makes tubing for 50,000 farmers per year.

China and India are the biggest potential markets, and Frykman has begun to tap both. In Xie's province, the Lingqiu County government is paying for the equipment for 200 local farms. Liu Wenbo, a county agronomist who has been overseeing the installations, says if the projects are successful the county will buy Driptech systems for hundreds more farms. "I think it will be very useful, not only in China," he says.

–Venessa Wong

PHYCAL

POWER FROM POND SCUM

Can algae help break America's dependence on imported oil? Kevin Berner thinks so

Kevin Berner, the 52-year-old CEO and founder of Phycal, is betting that green lagoons of algae are the cure for America's fossil-fuel addiction. Corn may be a good feedstock for ethanol, the nation's favorite biofuel, but algae plants are able to produce up to 100 times more oil per acre, according to the Energy Dept. Plus, algal ponds and containers can be put almost anywhere—from urban rooftops to vacant fields—so they need not displace other crops. And the plants can thrive in dirty or salty water, thus reducing the burden on reservoirs and aquifers.



Going green: Berner's system uses less energy to to produce fuel

Prolific as the plants may be, however, would-be producers of algal oil haven't cracked the problem of how to extract the fuel cost-effectively from the tiny, waterborne organisms. That's where Phycal has a leg up, says Berner. Backed by $15 million, the Highland Heights (Ohio) company is commercializing a novel chemical process that continuously squeezes oil from the microorganisms while they're alive. Competing approaches consume huge amounts of power cooking up the plants to harvest the oil, while Phycal's way dramatically cuts energy use and costs.

DESERT STORM EPIPHANY

Berner's romance with algae dates back to 2004. That's when he stepped down from a three-year stint running McKinsey & Co.'s manufacturing practice in Cleveland. He quickly turned to renewable fuels, motivated by his stint as an army paratrooper helping to drive Iraq's troops out of oil-rich Kuwait in 1991. "I realized then we can't keep fighting wars over oil," says Berner, a West Point graduate who lives in Cleveland with his wife and three sons.

If the algae business blooms, Berner won't have it all to himself. In the past two years, the number of players developing algal fuels around the world has tripled, to more than 70, says Harry Boyle, lead biofuels analyst at London-based consultants New Energy Finance. That includes fossil-fuel heavyweights such as BP, ExxonMobil, and Royal Dutch Shell.

To keep his lead, Berner is building a pilot plant using natural algae strains in Hawaii. It's on track to open in 2010 and should deliver biofuel at about $4 per gallon—on par with the state's notoriously high oil prices. *–Adam Aston*

MICHAEL NEMETH/WONDERFUL MACHINE

Success Begins with Innovation

INVEST JAPAN

Japan Regional Initiative – Biomedical Kansai: A Healthy Future



With the second largest economy in the world, Japan has long been an attractive choice for investment, and the government has been actively promoting measures to achieve Japan's goal of doubling total foreign direct investment here. However, while many firms and investors investigating Japan limit their search to Tokyo, those looking for the next wave of Japan's medical, pharmaceutical and biotech fields, should instead be turning to the Kansai region. Centered around the cities of Osaka, Kobe and Kyoto, Kansai is rapidly becoming one of the world's most successful biomedical clusters, concentrating top-level academic institutions and leading pharmaceutical companies, as well as hundreds of firms specializing in developing new drugs and cutting-edge medical devices. This region is the nation's second largest economy, with a population of over 20 million and a $723 billion-GDP*. In addition to its huge market, Kansai offers an excellent business infrastructure including a fully developed highway and rail network, and a 24-hour international airport. Kansai is also known as the home of world-famous electronics companies such as Panasonic and Sharp. Featuring all the advantages of Tokyo plus the added benefit of a growing pool of new and untapped investment potential, Kansai offers a business environment ripe with opportunities.

Good Chemistry

The biomedical industry has a long history in Kansai. Even today, five of Japan's top ten pharmaceutical companies are headquartered in this area. Over 200 of Japan's leading academic institutions are here, including Osaka and Kyoto Universities, plus research institutes engaged in advanced research in drug discovery and regenerative medicine. Numerous venture firms have been established here by researchers from Osaka University to put the results of their pharmaceutical research to practical use. At Kyoto University, researchers have succeeded in developing induced Pluripotent Stem (iPS) cells. The well-balanced combination of academia and industry is a key to accelerating innovation in Kansai, and biopharmaceutical companies, venture firms and universities are all looking for joint research opportunities with overseas partners. In addition to world-class research institutions, especially in Kobe and Osaka, Kyoto has commercialization incubator facilities, laboratories, and offices for low rental fees available for firms from around the world. These local governments are able to provide subsidies and tax incentives for starting up businesses in the area.

A Network of Innovation

As well as biopharmaceuticals, Kansai is also home to an extensive array of medical device companies, including many of the world's leading producers of state-of-the-art technologies. Japan's medical device industry is exceptionally robust, with annual sales of approximately $20 billion, a quarter of which are produced in Kansai. This figure is second only to the U.S., and is expected to grow by an additional 25% by 2012. In addition to the wide range of device makers located here, there is an even wider range of companies within the Kansai Biomedical Cluster working on the cutting edge of other fields, developing devices and technologies that are then adapted for medical applications. The Osaka Chamber of Commerce and Industry has organized the "Forum for the Industrialization of Next-Generation Medical Systems," an open platform for the joint development of medical instruments for clinical applications. They contribute matchmaking capabilities to create globally competitive medical devices in Kansai.

Welcoming the World

Japan Regional Initiative –Biomedical Kansai Project, a consortium of private businesses, government agencies, and academic research facilities throughout the Kansai region, will be in attendance at MEDICA 2009, an international trade fair showcasing pharmaceuticals, medical technology, and laboratory equipment to be held in November in Düsseldorf, Germany. The consortium will host an exhibition space at the fair to introduce overseas businesses in the biotech and medical fields to the advantages of partnerships in Kansai. In addition, they will also be able to provide information on the many incentives that are available here to promote alliances with local firms and attract investment to the region.

*2008 Kansai Economic White Paper



Top-level research institutes and biomedical firms are located throughout Kansai.

World medical device market, billion US$

Source: Espicom Business Intelligence, 2007 report



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060 Gazprom's American ambitions
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WHAT'S NEXT



NATHAN FOX

STRATEGY & COMPETITION

Dangerous Days For Video Games

As companies have to invest more to chase consumers, the $11 billion business is taking a hit

By Ronald Grover

For months, video game fans from Topeka to Tokyo had been salivating for Call of Duty: Modern Warfare 2, the sixth installment of Activision Blizzard's blockbuster shootfest. On Nov. 10, D-Day finally arrived. Thousands lined up outside Best Buy and other retailers to grab the game when it went on sale at midnight. In Puerto Rico, the GameStop chain rented a stadium to handle the overflow.

Given the pent-up demand, Call of Duty likely will be one of the year's biggest hits. So why are Wal-Mart and Amazon dangling $20 discount cou-

pons to lure buyers? Because the game business isn't what it was. As of October, according to the research firm NPD Group, sales were off 12% in the U.S. At the same time, production and marketing costs are climbing as Activision and other game makers try to compete with a growing array of other entertainment options. "I do think the economy is [hurting game sales]," says NPD analyst Anita Frazier. "But what's having an even greater impact is the availability of so many free games" on the iPhone and ad-supported Web sites.

THE DVD COMPARISON

Video game makers say their $11 billion industry will bounce back once recent price cuts spur sales of game consoles. But analysts have lowered 2009 sales projections, and there are troubling comparisons to Hollywood's DVD slowdown. Video game companies are being forced to invest more to chase consumers. Viacom spent at least $10 million to license music for the Beatles version of its Rock Band game, whose recent launch underwhelmed. It needs a big Christmas for Viacom to break even or turn a profit on the franchise, says Chief Financial Officer Thomas E. Dooley.

Call of Duty, in which American soldiers chase terrorists through the mountains of Afghanistan, is an especially pricey bet. CEO Robert A. Kotick says Activision ultimately will spend some $200 million to launch the game (including what it pays hardware makers to put it on their consoles). Call of Duty cost as much as $40 million to develop, figures Wedbush Morgan Securities analyst Michael Pachter, about double what other games cost. That included the services of Oscar-winning composer Hans Zimmer. The team that made the game, which at one point numbered 400 people, used state-of-the-art computer graphics and relied heavily on focus groups.

12%

Drop in 2009's U.S. video game sales as of Oct. 3

Data: NPD Group

Then there's the marketing campaign, which is costing $25 million or so. Activision spent $750,000 for two spots on the NFL's opening weekend and ran ads last spring during the NBA's Eastern Championship. As Call of Duty rolls out, Activision is plastering ESPN.com and YouTube with ads. On Nov. 10, Activision staged a premiere in New York's Union Square, where members of the New York Yankees played regular gamers. "They've really blown out the marketing on this," says Tony D. Bartel, GameStop's marketing chief, who says Activision let 5,000 of the retailer's managers play the game at the chain's annual conference in Las Vegas.

Activision will almost certainly get its money back, and more. Wedbush Morgan's Pachter figures it will sell more than 12 million copies of the $59.99 game by Christmas, generating over $580 million. Activision also expects to sell premium boxed versions of the game (which come with real night goggles) and online "map packs" that offer new battlefields for the warriors.

Still, the tough environment is forcing even the strongest players to retrench. After reporting a sizable loss on Nov. 9, Electronic Arts, maker of Madden NFL, announced that it was scaling back the number of games on its roster and will focus more on online titles. And while Activision generates some of the best profit margins in the business, it, too, has started playing safe. The company has three releases scheduled before Christmas, including Call of Duty and a Tony Hawk skateboarding game (which is played with a real skateboard). But Activision is delaying its highly anticipated auto racing game, Blur, to give its team more time to fine-tune it.

The question hanging over the industry is whether the game business will rebound once the recession lifts. Activision's Kotick insists it will when the next generation of game consoles arrives and draws new gamers. All the same, he says, Activision and its rivals will need to make "significant investments in creating compelling" titles. As in a video game, only the strongest may survive. |BW|





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From Russia With Not a Lot of Love

Gazprom, the bare-knuckle king of natural gas, is out to make its mark in America



Hattenberger wants to capture 5% of the U.S. gas market in five years

ROBERT SEALE

By Steve LeVine

Just how tough is Gazprom? As the world's biggest supplier of natural gas, the Russian company has a reputation for hard-nosed bargaining. So when John Hattenberger, chief of the company's new U.S. operation, hired George Thorogood and The Destroyers to play at a party marking the opening of Gazprom's Houston office, he insisted Thorogood leave his Epiphone guitar after the show. "That was clause 19 of the contract," Hattenberger jokes. Today the autographed instrument hangs above Gazprom's trading floor.

That's Gazprom with a sense of humor. But more often, its negotiating style is no laughing matter. In January, Gazprom slowed gas deliveries to Ukraine in a price dispute, leaving customers further down the pipeline in Central Europe shivering in the winter cold—the third time in three years Gazprom has taken similar steps.

Now, Gazprom has set its sights on the U.S. The company wants to sell liquefied natural gas shipped from Russia's east coast. And with two dozen traders working from the 25th floor of a Houston skyscraper, Gazprom hopes to become a big player in U.S. gas trading. While the company has yet to sell any LNG in the U.S. because it's getting higher prices elsewhere, its traders have found a niche in organizing swaps with European companies that have excess volume in the U.S. but need to shore up supplies at home. Hattenberger's five-year goal is to capture 5% of the U.S. gas market, selling 3 billion cubic feet a day.

The 54-year-old Minnesota native isn't new to bare-knuckle employers. He joined Gazprom four years ago, after a three-decade career that included a stint with Transworld Oil, which defied a U.N. ban on oil trading with apartheid-era South Africa. "Sometimes we do get a double take" at Gazprom, he says. "But we don't have any ulterior motives. We're here to make money like anyone else."

Gazprom needs a lift from the U.S. since plentiful supplies are likely to keep gas prices low in Europe for a decade

Many in the business say that goal may remain elusive. New technologies have made it possible to get at vast volumes of gas encased in shale, effectively tripling U.S. reserves. That has helped send prices down by nearly 80% and will surely cut demand for Russian LNG. "This game-changing shale play may mean we're going to be sending gas over to Russia," says Adam Robinson, a vice-president at RBS Sempra Commodities.

Even though Gazprom controls nearly a fifth of known global gas reserves, it could use a lift from the U.S. operation. The International Energy Agency says abundant supplies are likely to keep gas prices in Europe low for a decade or more, and Gazprom's second-quarter profit was off by 36% year-on-year. After borrowing heavily to pay Italy's Eni for the 20% stake it held in Gazprom Neft, an oil-producing unit, Gazprom saw its debt rise by 31% in the first half, to $48 billion. "The world has changed on Gazprom in a very short time," says Frank Verrastro, an analyst with the Center for Security & International Studies, a Washington think tank.

Hattenberger is confident he can ease Gazprom's troubles. He is already parlaying the company's heft in Europe into a trading business in the U.S. In October utility Electricité de France agreed to a swap, providing Gazprom with 50 million cubic feet of gas per day in the U.S. in exchange for the same amount delivered to EDF's operations in Britain. Hattenberger predicts that with the recession ending and worries about global warming spurring a shift to gas, "industrial demand will come surging back." Gas, he says, "will be king again." |BW|



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Indian vs. Chinese Autos: No Contest

India's exports are pulling ahead, thanks to quality and engineering that China's carmakers don't match



The first shipment of Maruti Suzuki exports destined for Europe

By Mehul Srivastava and Ian Rowley

DELHI

For years, global automakers have fretted about the day when Chinese manufacturers start exporting cars en masse, driving down profits worldwide. But the bigger challenge may come from China's neighbor, India. This year through September, India exported more than 292,000 cars, up 32% from the same period in 2008, while China's car exports fell 57%, to about 221,000.

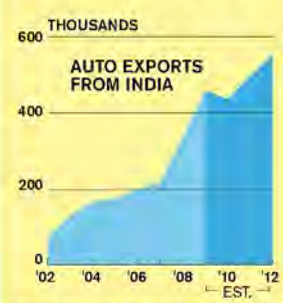
In contrast to China, where exports come mostly from domestic companies, India's biggest exporters are the global manufacturers themselves. They like the country because it's a fast-growing market with plenty of smart engineers; developing a small car in India costs about $225 million, vs. some $400 million in Europe, estimates researcher CSM Worldwide.

While costs in China are on a par with India's, China hasn't penetrated the European countries where India is strongest. The vast majority of Chinese cars sold abroad end up in the developing world. "India's advantage lies in its strong engineering skills and a large supplier base, which has learned to meet the strict quality requirements of European markets," says Ammar Master, an analyst with J.D. Power & Associates.

The biggest names in autos are ramping up production in India. Renault and Nissan Motor are building a plant near Chennai with an annual capacity of 400,000 vehicles and plans to export to Europe by next May. Ford is refurbishing a plant where it will build a small car called the Figo, which it aims to start exporting next year. And Volkswagen is boosting production at two factories in western India to 110,000 cars annually, many for export. "India offers a launchpad to develop and build small cars at a much lower cost [than in Europe]," says Rajesh Nellore, the India head for PSA-Peugeot Citroën, which is scouting land near Hyderabad for a factory with an annual capacity of 100,000 vehicles. "Those cars need not go through dramatic changes to suit Western needs."

The leaders so far are Korea's Hyundai Motor and Maruti Suzuki, a Japanese-Indian joint venture. With the introduction of the subcompact A-Star, the latter has doubled its European sales this year to 91,000. Hyundai expects to export 300,000 cars from India in 2009, mostly a pair of hatchbacks called the i10 and the i20. Tata Motors is close behind. Its hatchbacks and sedans do well in Italy and Britain, where Tata has invested in dealerships and a roadside assistance service so that "no matter where he is, our customer knows he won't be stranded," says Tata Managing Director Prakash M. Telang.

RISING TIGER



Data: Society of Indian Automobile Manufacturers, J.D. Power & Assoc.

That's not to say China won't overtake India in exports someday. Part of India's success this year is due to European cash-for-clunkers programs. China's car market, meanwhile, is about five times as big as India's and has grown 46% this year, spurring carmakers there to focus on the mainland rather than exports. At just 2 million vehicles last year, India's market is too small to warrant all the capacity the country now has, so manufacturers feel they need to export. "If you have a factory in China, you just fill it and sell the cars in China," says Colin Dodge, Nissan's chief for Africa, Middle-East, India, and Europe. "Don't [bother with] exports." |BW|

SAM PANTHAKY/AFP/GETTY IMAGES; CHART BY RAY VELLA/BW


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To meet seasonal demand, Glier is giving back to workers hours that were cut

ECONOMICS & POLICY

Small Business Has Small Hiring Plans

Even when the economy picks up, keeping the headcount down will remain a top priority

By Amy Barrett

SMALL BIZ

Without a doubt, the job picture is ugly. And if the 10.2% jobless rate is to start falling, economists say small businesses need to begin hiring. But the surplus of underutilized workers and tepid entrepreneur sentiment suggest small businesses will be unusually timid about bringing new employees on board.

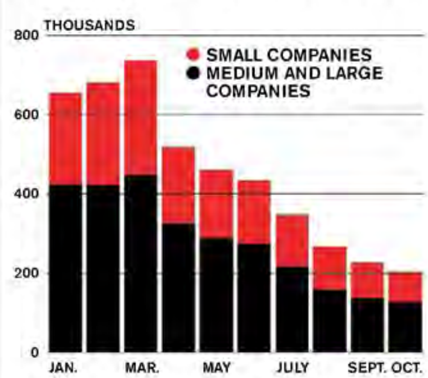
Big companies aren't likely to fill the gap. Brian A. Bethune, chief U.S. financial economist at IHS Global Insight in Lexington, Mass., says corporations have already set their 2010 budgets, and most aren't hiring. "So a lot hinges on the small-business sector," he says.

To be sure, the worst of the small-business job losses seems to be over. According to Automatic Data Processing's *National Employment Report*, companies with fewer than 50 workers slashed just 75,000 jobs in October, down from 288,000 in March. Midsize companies also shed 75,000 jobs in October, while big companies cut 53,000.

Small companies historically begin hiring first in a recovery. But this time many economists expect any pickup to be belated and weak. One big reason is the credit crunch's outsized impact on entrepreneurs. Douglas Duncan, president of Anaheim Hills (Calif.)-based Almond Hill Enterprises, a two-person software company, wants to hire back-office and marketing employees. But, he says, "I can't get the funding."

SMALL COMPANIES SHED JOBS

The worst of the cuts is over—but entrepreneurs may be less eager to boost hiring than in past recessions



Data: ADP National Employment Report

Other small companies have plenty of slack. The average paycheck for the 25,000 small-business clients of payroll processor SurePayroll fell 7.3% for the year through October, says President Michael Alter. That reflects, in part, a heavier reliance on independent contractors, he says. In fact, more than 4% of paychecks cut by his clients are issued to contractors—an all-time high.

Cuts in workers' hours are also helping shrink small-company paychecks. Ditto for the general economy, where the average workweek was only 33 hours in October, down from 33.5 a year earlier. When demand picks up, small companies will pile more work on existing workers rather than hire. "I think you'll see a jobless recovery," says Alter.

PLENTY OF WORRIES

One reason could be small businesspeople like Daniel W. Glier, president of Glier's Meats, an 18-person, $3 million sausage maker in Covington, Ky. He says he'll do whatever it takes to keep his headcount down. He's handling a bump in seasonal demand by hiking the hours of employees whose hours were cut earlier this year. Glier is also using temps. That way, if he has to let them go, his unemployment insurance premiums won't rise. Because of uncertainty over taxes and health-care reform, "I'm not going to stick my neck out right now and hire people," he says.

The weak recovery is a concern, too. The optimism index compiled by the National Federation of Independent Business has edged up from its March nadir. But at 89.1, the index has been below 90 for six straight quarters. In the 1980-82 recession, it fell below 90 only once. An October survey by credit-card issuer Discover Financial Services found the biggest worry for entrepreneurs is the outlook for sales—even ahead of their usual bugaboos, taxes and health insurance. Until sales improve, hiring will be scarce. |BW|

PHOTOGRAPH BY HAROLD LEE MILLER; CHART BY DAVID FOSTER

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Imaginative Designs That Change the Game

The 12th annual *BusinessWeek/Architectural Record* Awards showcase smart new retail and office spaces



By Reena Jana

The new Barbie Shanghai store is a bit far down the Huaihai Road shopping corridor, but it's hard to miss. An eight-story glass façade, printed with a lacy design of hearts and flowers, glows with pink lights at night. Opened in March, it's the first flagship shop devoted entirely to Mattel's iconic, 50-year-old doll. The goal: attracting Chinese consumers to help offset a worldwide decline in Barbie sales.

In its showiness, Mattel's temple to Barbie might seem out of sync with these back-to-basics times. But it has a practical side that fits right in. Indeed, Barbie Shanghai and the other seven winners of the 12th annual *BusinessWeek/Architectural Record* Awards show the value of new architecture even in a recession. From software maker Autodesk to retailer Urban Outfitters, companies are finding that carefully executed buildings can help reduce operating costs, boost staff output, and revive communities.

Imaginative building design might also speed their occupants to financial recovery and growth. "Employers need to find every advantage they can today," says Robert Ivy, editor-in-chief of *Architectural Record* and a judge of this year's contenders. "Effective design can result in creative environments that can yield higher worker productivity, marketing clout, higher profiles for companies, and employee satisfaction."

In addition to serving as a conventional store, the 35,000-sq.-ft. Barbie Shanghai was designed to be a laboratory where Mattel could experiment cheaply with retail tools that might be employed in other markets. Mattel worked with New York-based Slade Architecture over three years to create an attention-grabbing centerpiece: a circular staircase enveloped with wraparound clear shelves housing 800 Barbie dolls. This fall some of the store's cube-shaped displays and shelves have been copied in a temporary Barbie store in the Mall of America in Bloomington, Minn., which will be open through next March.

The $10 million structure also houses a Barbie-themed restaurant and a beauty parlor to generate repeat visits. Mattel reports having 17,000 visitors on opening weekend and about 20,000 shoppers each week since. About 10% of visitors buy "Barbie Passports," or loyalty cards that provide discounts on purchases, meals, and haircuts. "The Barbie Shanghai store was about remaking Barbie for the world, and not just for China," says Richard Dickson, general manager of the Barbie brand.

Autodesk had a slightly different agenda when it hired architects KlingStubbins of Cambridge, Mass., to design a headquarters for its 175 employees in its Architecture, Engineering & Construction Solutions (AEC) office in Waltham, Mass.

AUTODESK
Waltham, Mass.
KlingStubbins
AEC Division
The company's 175-employee AEC unit features private meeting rooms with transparent yellow glass walls so other employees can see the goings-on



(TOP TO BOTTOM) IWAN BAAN; JEFF GOLDBERG/ ESTO



BARBIE STORE
Shanghai
Slade Architecture
Mattel
A circular staircase enveloped with wrap-around clear plastic shelves holding 800 Barbie dolls provides an attention-grabbing centerpiece



The software maker wanted a building that would foster both creativity and productivity. Autodesk began by asking employees what would help. The 60,000-sq.-ft. building features undulating interior canopies over tables and chairs that are set up in high-traffic sections to encourage chance brainstorming sessions. There are also private meeting rooms with floor-to-ceiling yellow glass walls so employees can see the goings-on.

In addition, the AEC building features a 5,000-sq.-ft. gallery and meeting space where staff members can brief clients, an element that Autodesk's previous offices didn't have. In the gallery, clients look at videos and models of buildings made with Autodesk software, which include the AEC structure itself. Jay Bhatt, who heads the AEC division, says that sales representatives are "bringing in more customers than ever" in the new location, although he won't disclose sales figures.

Urban Outfitters was a pioneer when it moved in 2008 to a new $100 million headquarters in the Philadelphia Navy Yard, a down-on-its-luck district. Today, the Philadelphia Industrial Development Corp. is trying to fill the area with energy-related startups.

The retailer's 285,000-sq.-ft. campus isn't just an urban renewal tool, however. It consolidates offices for the company's five brands of clothing and housewares that had been scattered across Philadelphia. Housing more than 1,000 employees in a single site, the company hopes, will improve communication among staff and trim costs.

The Urban Outfitters campus was designed and completed in only 20 months, in part because many of the Navy Yard's original materials were repaired and reused. To hurry things along, David Ziel, the retailer's chief development officer, also pushed architects Meyer, Scherer & Rockcastle of Minneapolis to design the structure as it went up. Construction began on the exterior, for instance, while designers were just starting on interior drawings. The company is betting further on architecture: Ziel says Urban Outfitters recently signed an option on five more buildings at the Navy Yard, anticipating future growth. |BW|



URBAN OUTFITTERS
Philadelphia Navy Yard
Meyer, Scherer & Rockcastle
Housing more than 1,000 employees on a single site, the new headquarters makes use of many of the Navy Yard's original materials and structures

BUSINESSWEEK.COM | For a video on the three buildings featured here and a slide show on all eight winners, go to businessweek.com/go/09/architecture

(FROM TOP RIGHT) IWAN BAAN, LARA SWIMMER

Buddy, Can You E-Mail Me 100 Bucks?

The Next Big Thing in U.S. banking may be mobile person-to-person money transfers



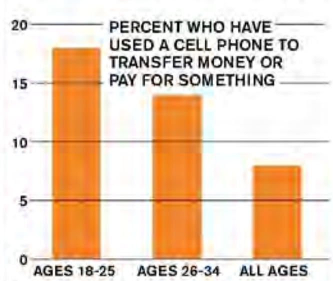
By Amy Feldman

What if you could send money to that friend who loaned you $20 last week by using your mobile phone rather than having to go through the trouble of trekking to the ATM or mailing a check? All you'd need would be your buddy's e-mail address or cell number—and presto.

Folks in Japan and Europe can already do that. Soon Americans will, too. Studies show that U.S. consumers, particularly the younger set, have embraced the convenience of online shopping and e-banking and are now ready to move to the next frontier: person-to-person mobile payments. A recent poll by Mercatus, a financial consulting firm, showed that the proportion of people ages 26 to 34 who had used a cell phone to buy goods or pay for a product or service had doubled, to 14%, in the past year. "We are at the tipping point," says Mercatus managing partner Robert Hedges.

That's why a host of banks and financial companies are gearing up to add person-to-person payments to their existing mobile and online banking platforms. PNC Financial Services, Bank of the West, and the Boeing Employees' Credit Union have teamed up with CashEdge, an outfit that already processes more than $50 billion a year in transactions among financial institutions, with plans to launch services in early 2010. Fiserv, a technology company that handles bill payments for 3,100 financial institutions, is marketing a similar service. MasterCard is working with Obopay, a mobile payment startup with funding from Nokia, while Visa has been testing a service with U.S. Bancorp. "Payment habits change pretty slowly, but Generation Y expects this," says Thomas S. Kunz, director of payments and e-business at PNC Financial.

EARLY ADOPTERS



Note: Based on a June 2009 survey of 1,100 U.S. consumers
Data: Mercatus

While the banks are only now waking to the potential of person-to-person payments, PayPal has built its business on them. The company, acquired by eBay in 2002, boasts more than 78 million active account holders worldwide and introduced a service earlier this year that allows users to make transfers over a cell phone. Now it is teaming up with banks to offer the same service. FIS, a tech outfit that counts 14,000 financial institutions as clients, announced on Nov. 3 that it plans to integrate PayPal's technology into its online banking platform. "We found out that [banks] want to collaborate more than ever," says PayPal President Scott Thompson.

HACKER HEAVEN?

Here's how these digital cash transfers work. Sign up for a service through your bank or another provider. Enter an e-mail address or phone number to send money to anyone you know. Your bank's person-to-person payment system will be integrated with your regular online banking, and the funds will be debited from your account. At the other end, the recipient may get the cash deposited directly into an account or have it posted to an existing credit card or a prepaid card. Mostly likely, banks will make money by charging senders a nominal fee (25¢, say, for a domestic transfer).

What about security, you ask? "Banking on the mobile phone is relatively safe," says Robert Vamosi, an analyst on security, risk, and fraud at Javelin Strategy & Research. In fact, says Vamosi, mobile banking is currently more secure than online banking because cellular networks are tough to hack into.

With many of these new offers set to launch next year, the big question is who will gain critical mass quickly. Says Jim Bruene, editor of trade publication *Online Banking Report*: "Whoever can make mobile payments as simple as sending a text message is going to win." |BW|

ILLUSTRATION BY AARON ARTESSA; CHART BY JOE RHAMES/BW

070 How to Play It: Technology in Taiwan
071 Investing: Battered real estate debt
072 Life Management: Second-career startups
076 Inside Wall Street

MONEY REPORT By Ben Levisohn

UPGRADING YOUR MUNIS

Allstate is weeding out some of its municipal bonds. On Nov. 5 the insurance giant announced in a conference call that its muni position had dropped 4% in the third quarter, to $22.2 billion on Sept. 30. It's not planning to eliminate munis altogether—state and local government bonds still account for more than 20% of Allstate's investments. But it's selling bonds from some riskier parts of the market. On the way out are health-care-related munis and certificates of participation, a type of security backed by a municipality's budget appropriations rather than its taxing power. With Allstate's zero-coupon bonds, which repay face value at maturity but pay no coupons along the way, rising interest rates are the worry. ¶ Neil Klein, a senior portfolio manager at Carret Asset Management in New York, says investors should follow a similar strategy and invest in high-quality bonds backed by either taxes or revenue from essential services, such as utilities and water treatment. He also recommends short and intermediate-term maturities to reduce exposure if interest rates rise.

EXCHANGE-TRADED FUNDS

FOR LONE STAR FANS

On Nov. 4, Texas became the second U.S. state to get an exchange-traded fund of its own. Keith Geary of Geary Advisors says his company launched the Texas Large Companies ETF in part because of performance. A computer program showed that if the portfolio had existed five years ago it would have outperformed the S&P 500-stock index by 32 percentage points, he says.

But the fund is not a bet on the Texas economy, says Scott Burns, director of ETF analysis at Morningstar. Top holdings include ConocoPhillips, ExxonMobil, and Schlumberger—global companies that just happen to have headquarters in Texas. Energy dominates the ETF, at 63%. Burns says investors can achieve similar exposure by purchasing the Energy Select Sector SPDR and the SPDR S&P 500 fund and save on management fees. The Texas fund's expense ratio is 0.85%, compared with less than 0.22% for the SPDRs. (Geary says this is a result of the fund's small size.) Ultimately, says Burns, the fund is for investors with a soft spot for the Lone Star State. "It doesn't have a fit in portfolio allocation," he says. "You're paying up to invest your pride in your state."

63%

Amount of Texas Large Companies ETF's assets in energy stocks

Data: Geary Advisors

PRECIOUS METALS

A REFUGE IN GOLD

Gold closed above $1,100 an ounce for the first time on Nov. 9 and is up 25% so far this year. It's not rising just because the U.S. dollar is falling, although the greenback gets a lot of attention. Investors are equally worried about the pound, the euro, and the yen. With governments around the world printing money, global inflation is the real fear—and investors are buying gold as an insurance policy against their currency holdings. "Gold's a replacement because those currencies aren't a safe place to be," says Richard Kang, chief investment officer at Emerging Global Advisors, which sets up exchange-traded funds. Still, fear hasn't turned to greed yet, says Kang. If gold trades above $1,250, watch for Wall Street's herd mentality to take over. That's when momentum traders could jump in. "That would be the trigger," he says. "We could easily see $2,000."



WILLIAM ALBERT ALLARD/NATIONAL GEOGRAPHIC/GETTY IMAGES

COUNTRY REPORT

TAIWAN'S NEW DREAMS

(FROM PAGE 040)

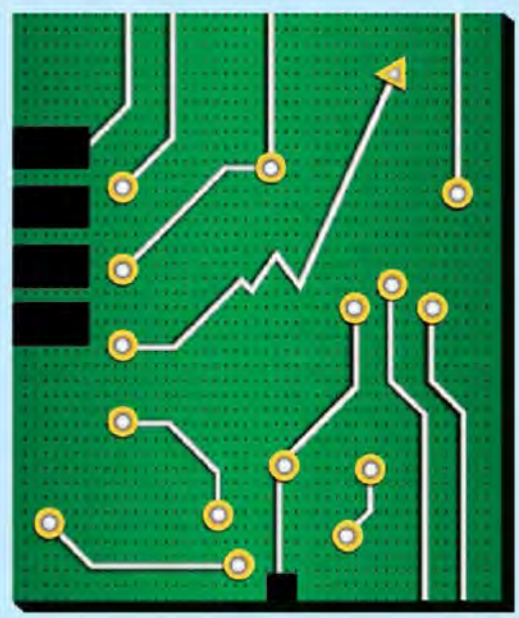
By Frederik Balfour

Taiwanese companies got whacked worse than most during the downturn, as exports of such products as semiconductors and liquid-crystal displays plunged. Taiwan's tech-heavy stock market fell nearly 60% from its September 2007 high to its nadir last November. Since then the Taiwan Stock Exchange index has risen about 90%.

Taiwan's bourse is home to a few truly global tech companies, including the world's largest producer of outsourced chips, Taiwan Semiconductor Manufacturing. Many of Taiwan's major tech stocks trade as American depositary receipts in the U.S., but its market still behaves like that of an emerging economy. "Investors have to be aware that it's very volatile," warns Renee Hung, deputy chief investment officer at Hong Kong-based Value Partners.

After such a rapid rebound, is Taiwan's market overheated? Not when you take into account expected earnings growth, says Mike Shiao, who manages the Invesco Greater China Equity Fund in Hong Kong. "We definitely do not think it's expensive, though it has a 2010 price-earnings ratio of 16, compared with a non-Japan Asian average of 14," he says. "That's because Taiwan has much stronger earnings growth of 67%, compared with 27%" for Asia without Japan. For investors who want broad exposure to Taiwan's market, there is an iShares MSCI Taiwan Index Fund, as well as a closed-end fund, the Taiwan Fund.

William Tung, chief investment officer of JPMorgan Taiwan Asset Management, says cost-cutting has been "a mantra" for Taiwanese stocks and that they "have fine-tuned operations so well that after the [down] cycle they are healthier than before." Prices have fallen so much that electronics are affordable for many consumers in emerging markets, he says. Those markets account for some 50% of end demand for information technology products.



Shiao's tech-heavy fund owns Taiwan Semi as well as electronics component supplier Hon Hai Precision Industry. Taiwan Semi got some good news recently. It won a $200 million settlement from Chinese rival Semiconductor Manufacturing International for trade secret theft. The settlement includes an option to buy up to 10% of SMIC, which would give Taiwan Semi a strong foothold on the mainland.

OVERTAKING DELL

A company Tung says has emerged from the crisis with better margins is Quanta Computer, one of the biggest makers of notebooks for Hewlett-Packard, Dell, and others. The company has won a number of new contracts for next year. Says Quanta Chairman Barry Lam: "Next year the industry will grow by 20%, and we will grow by 40%."

Some of Taiwan's tech companies are also poised to benefit in the post-PC era as mobile devices acquire more functions of the traditional computer. AUO, the world's third-largest LCD panel maker, is preparing to manufacture for a rival to Amazon.com's Kindle e-reader. AUO's biggest Taiwanese competitor, Chi Mei, the world's fourth-largest LCD maker and a major supplier to Chinese television makers, is benefiting from strong local demand.

Value Partners' Hung is also keen on tech and is impressed by smartphone maker HTC. It launched the first Android smartphone last year and came out with the $180 HTC Hero for U.S carrier Sprint. Hung says the HTC Hero is giving the iPhone a run for its money.

Investing opportunities outside the tech industry are emerging as relations between China and Taiwan improve. In addition, reductions in taxes on capital gains and inheritance are helping to reverse years of capital flight and boost domestic spending. Taipei-based retailer Far Eastern Department Stores has been a beneficiary of that: Its shares have more than doubled since January. | BW |

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ILLUSTRATION BY OLIVER MUNDAY

COMMERCIAL REAL ESTATE

VALUES IN MAULED DEBT

The news about U.S. commercial real estate is grim ("Deep Trouble," Nov. 16). But distress can lead to opportunity. Michael Winer, manager of Third Avenue Real Estate Value Fund since its 1998 inception, has proved particularly adept at navigating chaotic environments and profiting from messy restructurings or bankruptcies. Associate Editor Amy Feldman spoke with Winer about strategies for capitalizing on battered real estate.

You recently had just 20% of assets in U.S. real estate stocks, your lowest level in 11 years. Don't you see any opportunities in commercial real estate?
It's tough to find great value in public securities in the U.S. commercial market. A lot of debt will be maturing over the next few years, and there's no clear picture of how this debt will get refinanced without new equity. Real estate investment trusts [REITs] have been reporting third-quarter results, and it's pretty ugly.

36.5%

One-year return, as of Nov. 10, for Third Avenue Real Estate Value Fund

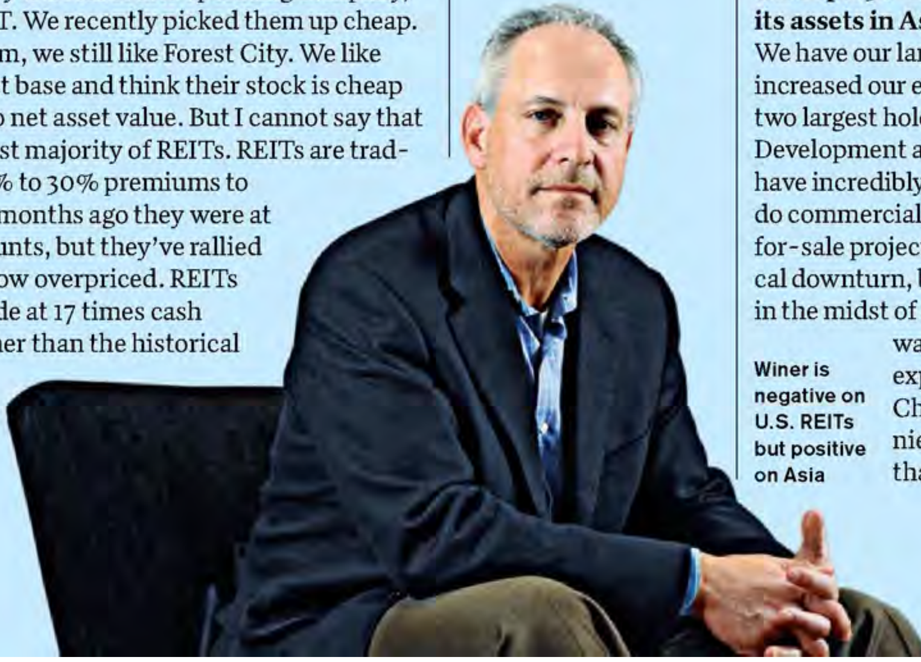
Data: Morningstar

Yet you have stakes in a few U.S. real estate companies, including Forest City Enterprises, your top holding.
Forest City is a real estate operating company, not a REIT. We recently picked them up cheap. Long-term, we still like Forest City. We like their asset base and think their stock is cheap relative to net asset value. But I cannot say that for the vast majority of REITs. REITs are trading at 20% to 30% premiums to NAV. Six months ago they were at big discounts, but they've rallied and are now overpriced. REITs today trade at 17 times cash flow, higher than the historical average. And you have to think cash flow will be lower a year from now because leases will come up and renewals will occur at lower rates; at the same time, interest costs are going up. So they're getting squeezed from both sides. That's why we are so heavily invested outside the U.S. and why we like Asia.

Before we turn to Asia, tell me about the REITs you do own.
We own ProLogis, Vornado Realty Trust, and Kimco Realty Trust. [ProLogis is an industrial player, Vornado a commercial one, and Kimco's focus is shopping centers.] We bought ProLogis and Kimco when the stocks were cheap earlier this year. Vornado's been a long-term holding. It's one of the few REITs we believe will be able to capitalize on future distress in real estate.

Do you see other distressed plays?
We made several investments in distressed companies over the past year and a half, including Newhall Land Development [a private California company]. We bought about $100 million of senior secured debt at distressed prices and were involved in the reorganization. It came out of bankruptcy in July. We own about 10% of the reorganized company's equity. Last winter we also invested $100 million or so in the debt of several U.S. REITs that was trading at 40¢ to 60¢ on the dollar. That has rallied to 90¢ on the dollar or better. We also bought the bank debt of General Growth Properties prior to its filing for bankruptcy. We bought it at 20¢ on the dollar, and it's trading at more than 80¢ on the dollar. One of our big advantages is we're not restricted to U.S. stocks. If I were managing a U.S. REIT fund, I'd be 75% in cash.

On Sept. 30 the fund had more than 25% of its assets in Asia. What's the appeal there?
We have our largest exposure—and have increased our exposure—in Hong Kong. Our two largest holdings there are Henderson Land Development and Hang Lung Properties. They have incredibly strong financial positions. They do commercial development and residential for-sale projects. Hong Kong was in a cyclical downturn, but it snapped back and is now in the midst of a rally. We've always felt there was long-term benefit to having exposure to the growth of mainland China through Hong Kong companies. China is going to be a machine that's hard to stop. BW



JENNIFER S. ALTMAN

Winer is negative on U.S. REITs but positive on Asia

INVESTING IN RETIREMENT

PASTIMES INTO PROFITS

By Lauren Young

For 15 years, Dorothy Atkins kept a diary during her long train rides back and forth to work as a project manager at a large San Francisco bank. "I always used commuting time to write out my hopes and desires," Atkins says. She also did a lot of drawing, illustrating "pearls of wisdom" imparted from friends and family, sometimes even making a card for a friend from the scribbles.



Atkins has transformed her commuting pastime into a profitable venture

ERIC MILLETTE

When Atkins was offered a buyout in 2002 at age 60, she was caught off guard. "The package scared me to death. I had not planned for not working," she says. After meeting with human resources to discuss her options, she went to Nordstrom and took comfort from a little shell-shocked shopping, buying a pair of shoes and some Godiva chocolate. Later that week, after reality had sunk in, she consulted her wish book and realized she wanted to turn her doodles into greeting cards.

Now Atkins has a successful company called From Where I Sit. Her cards are sold in museums and high-end boutiques. Her income doesn't match her old salary, but provides a good supplement to her retirement savings.

More older workers are trying to make second or third careers work. The unemployment rate for persons aged 55 and over hit 7% in October, continuing the recent trend of high jobless rates for older persons not seen since the late 1940s, according to an analysis of Labor Dept. data by Sara Rix of AARP's Public Policy Institute. The average period of unemployment is nearly 34 weeks for older job seekers, more than 13 weeks longer than it was at the start of the recession. "The chance of a 60-year-old finding an ad on Craigslist that says, 'Wanted: Vice-president of marketing and sales. Must be 60 to apply' doesn't exist, so you might as well take your skill set and make it into an encore career," says Mary Furlong, a baby-boomer marketing expert and author of *Turning Silver into Gold: How to Profit in the New Boomer Marketplace*.

Making a leap into a second or third career may mean taking financial risks. Some people use severance payments as seed money. Others tap credit cards, family, savings, even retirement accounts. Dipping into reserves to fund the next stage of your life may not feel great when cash flow is a concern. But it's often necessary.

MELDING EXPERTISE

Ideally, a later-in-life career change means turning a passion into a profit-making enterprise, as Atkins was able to do. It also often involves finding a way to blend different areas of expertise, which is what Laurie Orlov is doing. From 1998 to 2007, Orlov was an analyst at Forrester Research, a technology research firm. A well-respected figure in the tech arena, she also served as the primary caregiver for

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slpc 21036 (10/09) (exp 4/11)



Douglass says the timing was right for a company that promotes humane farming

her mother, even self-publishing a book for caregivers called *When Your Parents Need Elder Care: Lessons From The Front Lines* (it cost $1,500 to produce). After her mom died in 2006, Orlov moved to Florida and began thinking of ways to meld her skills. Last March, she launched Aging in Place Technology Watch, a research firm analyzing the market for technologies that help boomers and seniors stay in their homes.

To gain an edge in the field, Orlov, 58, spent about $5,000 to get an online graduate certificate in geriatric care management from a local university. Starting a blog has also been crucial to building credibility, she says. Orlov makes a point of accepting speaking engagements as well as attending conferences to get the word out about her business. "If I pick up a new client at every conference I attend, it is worth the registration and travel costs," she says.

Another place to make connections and find resources to help build a new career is your alma mater or local college. Michael Lesner, who is "fiftysomething," worked for decades as a marketing and media executive at firms such as Leo Burnett and CBS before founding AcuNetx, which makes diagnostic tools to prevent senior citizens from falling. He's using his marketing and media experience to serve as a board member and mentor for MBA candidates at Pepperdine University's Graziadio School of Business. "It's an incredible networking tool," he says. He persuaded the graduate school to use his new venture as part of the curriculum. In return, he's getting free marketing, financial, and management advice.

FINDING SEED MONEY

While Atkins, the card entrepreneur, got a buyout package that equaled more than a year's pay, not everyone has the luxury of a retirement package or savings to fall back on. That leads some people, like Adele Douglass, to raid retirement accounts.

After working as a lobbyist on animal rights and children's issues, Douglass left her job at 57 and cleaned out her retirement savings, worth more than $80,000, to launch Humane Farm Animal Care, a nonprofit in Herndon, Va. Her organization certifies that livestock for meat, poultry, and dairy products was treated humanely. She doesn't regret using her savings. And with the popularity of the local-food movement, the timing was perfect. Thanks to her group, she says, nearly 23 million animals were raised under certified humane standards last year, up from 143,000 animals in 2003. Her financial safety net right now, she says, is her three children: "My kids would never let me be out on the street."

Other self-starters have tapped into the value of their homes—an option no longer available for many would-be borrowers. Connie and Thomas Betts sold their Portland (Ore.) home in 2003 and bought a farm in central Oregon. They sold their 41-foot sailboat for $50,000, and used the money to buy the four pregnant alpacas and a herd sire needed to start Cascade Alpacas ranch. They also borrowed $30,000 to buy inventory for a yarn shop on an American Express OPEN Card, a credit card geared to small business owners.

The business is thriving. They have 50 alpacas and make the bulk of their income selling pregnant females to other farms for as much as $22,000 each. Recently, to cover the cost of purchasing a neighboring farm, Connie, 56, who formerly worked as a writer of technology training manuals, returned to work. For now, that leaves Thomas, 55, a former marine-supplies executive, to run the ranch and shop on his own. The trade-offs are worth it, says Connie. "It's a wonderful life." |BW|

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CHRIS USHER

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CHINA: ASSAYING NEWMONT?

In just a week, Newmont Mining (NEM), one of the world's top producers of gold, saw its stock leap to 51.24 from 43. The jump is no surprise, since Newmont's third-quarter profits more than doubled as gold hit $1,100 an ounce. But there's something more intriguing: The speculation on Wall Street that China may be eyeing Newmont.

NEWMONT MINING: THE GLEAM OF GOLD



Data: Bloomberg

"The buzz is that if China wants to protect its currency and diversify its assets, it makes sense to buy Newmont," says Vincent Carrino of Brookhaven Capital Management, which owns stock. In 2008, Newmont's proven and probable gold reserves were 85 million oz., in such places as Nevada, Peru, and Australia. Carrino figures Newmont is worth 70.

China this year acquired a majority stake in Australia's OZ Minerals for $1.7 billion after an unsuccessful run at mining giant Rio Tinto. China's current No. 1 gold producer is China National Gold, accounting for 20% of the country's output. In 2007, China mined 9.7 million oz.—7% of the global yield.

Jared Levin of investment firm A.R. Schmeidler, which owns Newmont stock, says China is also rumored to be interested in buying gold from the International Monetary Fund. A Chinese consulate spokesman wouldn't comment beyond saying that China's sovereign wealth fund "is always a stabilizing force in the international market."

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COOPER PUMPS RIGHT UP



Data: Bloomberg

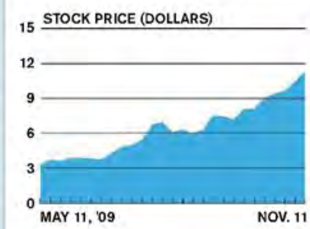
More Bounce at Cooper Tire

Despite major roadblocks, including a recession that paralyzed the auto industry and crimped driving habits, Cooper Tire & Rubber (CTB), North America's No. 4 tire maker, has sprung back and is expected to turn a profit this year after a huge loss in 2008.

Cooper, which posted solid sales and operating earnings in the second and third quarters, has cut costs and improved efficiency while gaining market share overseas, says Zacks Investment Research, which rates it outperform. The shares have climbed to 18.38, up from 2.96 in March.

A near-term sales opening for Cooper, says Saul Ludwig of KeyBanc Capital Markets, is remedying the inventory shortage caused by cutbacks at dealers. So Ludwig raised his 2009 earnings projection to $1.80 a share from $1.40, and his 2010 forecast to $2.10 from $1.75. He rates the stock a buy, lifting his target to 25 from 23.

PROTALIX BIOTHERAPEUTICS



Data: Bloomberg

A Promising Israeli Biotech

Little-known Protalix BioTherapeutics (PLX) has surprised the Street. The stock has hit 11.33 on NYSE Euronext, up from 4 in June.

The Israeli company's lead drug, prGCD—a treatment for Gaucher's disease, a genetic disorder that causes blood problems and enlargement of the liver and spleen—showed favorable results in phase III clinical trials. It also met efficacy and safety targets, says Brian Abrahams of Oppenheimer (it has done banking for Protalix), who rates it outperform. He figures a large U.S. drugmaker may partner with Protalix or offer to buy it. If prGCD gets FDA approval, the drug will compete with Genzyme's big-selling Cerezyme, which is in short supply, says Abrahams. The clincher for Protalix, notes Raghuram Selvaraju of Hapoalim Securities, is its low-cost, plant-cell-based method of producing enzymes. He rates Protalix a buy. |BW|

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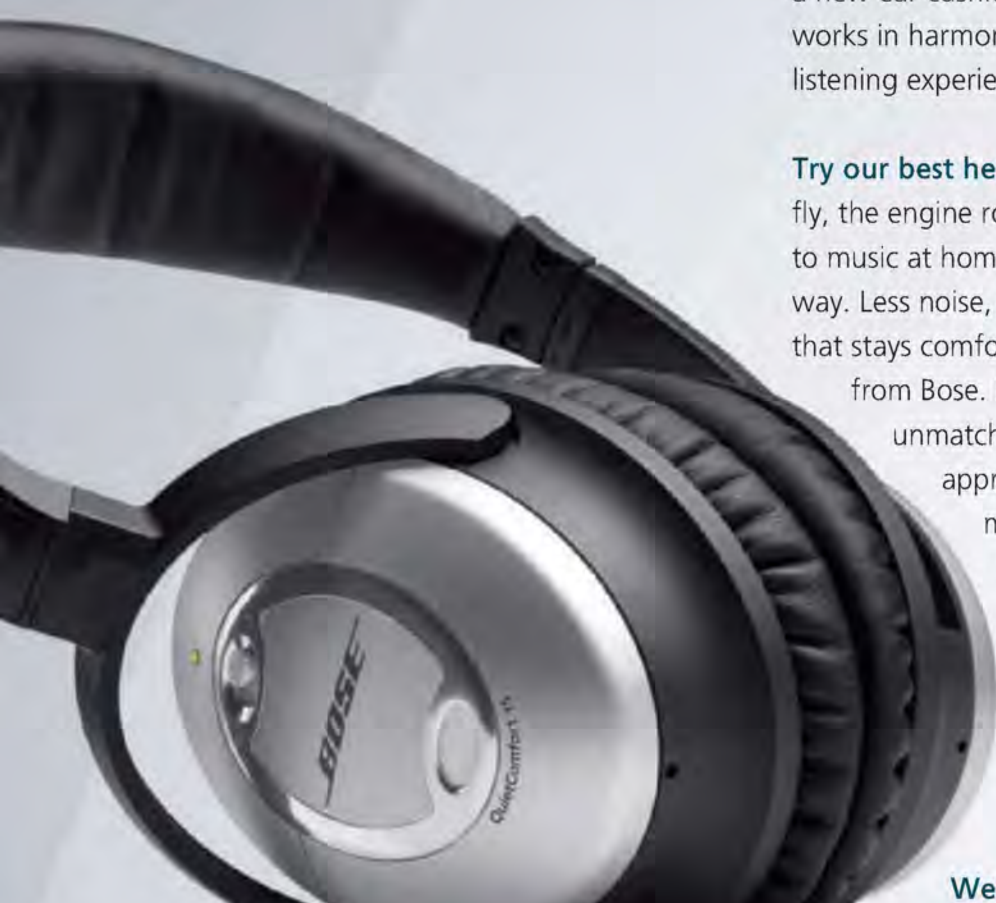
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BOOKS | CHRISTOPHER FARRELL

The High Cost of Blind Faith in the Market

To avert further calamities, John Cassidy argues, we should practice "reality-based economics"



JACOB THOMAS

Economist John Maynard Keynes had a weakness for rhetorical flourishes. At the end of his classic *The General Theory of Employment, Interest, and Money*, he wrote: "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist." To author John Cassidy, it's a quote that applies to the practical decision-makers of our own time—and that explains the roots of our own Great Recession.

In his ambitious *How Markets Fail: The Logic of Economic Calamities*, Cassidy, an economics writer for *The New Yorker*, offers a powerful argument that the current generation of investors and policymakers has been manacled by what he calls the "utopian" free-market school of economics. In an effort to debunk that "ideology," which he sees as holding sway in academia and among policymakers in recent decades, Cassidy marshals a deep understanding of economic intellectual history, deftly explaining the principal ideas of such towering figures as Adam Smith, Friedrich von Hayek, Léon Walras, Kenneth Arrow, Milton Friedman, and Robert Lucas. This long view allows him to place in context the free marketers' notion that self-interest and competition "equals nirvana." In the author's words: "Between the collapse of communism and the outbreak of the subprime

080 BOOKS

crisis, an understandable and justified respect for market forces mutated into a rigid and unquestioning devotion to a particular, and blatantly unrealistic, adaptation of Adam Smith's invisible hand." And it was this faith, he goes on to say, that led Alan Greenspan, among others, to turn a blind eye to what was happening in the real world of money and business.

Cassidy has his intellectual heroes, too. They are the advocates of what he calls "reality-based economics"—grappling with market failures, disaster myopia, speculative frenzies, and other economic complexities. John Maynard Keynes, the great scholar of economic-crisis management, is one such thinker. So are the experimental psychologists Amos Tversky and Daniel Kahneman, the mathematician Benoit Mandelbrot, and Hyman Minsky, the expert on financial manias. "Reality-based economics ... affords the concept of market failure a central position, recognizing the roles that human interdependence and rational irrationality play in creating it," writes Cassidy. "If further calamities are to be avoided, policymakers need to make a big mental shift and embrace this eminently practical philosophy."

How Markets Fail is a nuanced book. That's a major attraction in an era when shrill commentators bicker crudely about government vs. markets and liberty vs. socialism. Even the portrait of Greenspan, perhaps the closest figure to a villain in Cassidy's account, is drawn with a measure of empathy. Yet this book can provoke angry questions in the mind of the reader. Why did so many smart economists, including Robert Lucas and Eugene Fama, refrain from protesting as their ideas were hijacked and abused by demagogic politicians and messianic think tanks? The scholars knew the exceptions, the qualifications, and the heroic assumptions that lay behind their market models. Why, then, didn't they take issue with the op-ed and cable-TV table-pounders who twisted their thinking?



How Markets Fail: The Logic of Economic Calamities **by John Cassidy; Farrar, Straus & Giroux; 390 pp.; $28**

Cassidy agrees with free-market advocates that the market performs wonders, but he believes its reach is limited. In that spirit, he favors greater government regulation of the financial-services industry. Although he doesn't dwell much on practical ideas for reform, he argues that it's necessary to tame Wall Street now that financiers have learned they can privatize profits during good times and socialize losses in bad. He admires the changes that came out of the Great Depression, such as the Glass-Steagall Act, which separated banking from investment banking. Even if current legislators aren't willing to go that far, banks must be required to keep more capital on hand and be given limits on how much debt they can accumulate, he says. He considers the proposed Financial Product Safety Commission a sensible idea. "The proper role of the financial sector is to support innovation and enterprise elsewhere in the economy," he writes. "But during the past 20 years or so, it has grown into Frankenstein's monster, lumbering around and causing chaos."

The author doesn't offer the reader any juicy bits of gossip. There aren't any vivid recreations of tense negotiations over an investment bank's future. Yet he brings ideas alive. More important, the reader comes away persuaded that reality-based economics can play a critical role in what the 18th century British conservative Edmund Burke called "one of the finest problems in legislation, namely, to determine what the state ought to take upon itself to direct by the public wisdom, and what it ought to leave, with as little interference as possible, to individual exertion."

Let's hope the legislators in Washington share this principled view of their role. Cassidy makes a compelling case that a return to hands-off economics would be a disaster. |BW|

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No Mea Culpa

On his blog, economics writer David Warsh offers a different take on whether some economists must share the blame for the financial meltdown. In contrast to Paul Krugman and others who have argued that economists "got it wrong," Warsh offers evidence that, "broadly speaking, economics has served us well in understanding and managing the crisis."

To read Warsh's blog go to **bx.businessweek.com/economic-analysis/reference/**

■ Foreign Direct Investment

Madrid, 21th October 2009

SPAIN RANKS SIXTH AMONG OECD COUNTRIES MOST INVESTED BY FOREIGN COMPANIES

Spain moves up two places on the Foreign Investment league table and is now the sixth biggest receiver of foreign invest

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The Stubborn Luxury of Apple

It could grab more market share by moving downmarket, but don't hold your breath

It's no secret that Apple is doing really well at the high end of the personal computer business, but the other day I got some data that cast its recent achievements in a whole new light. In September, according to market researcher NPD Group, Macs accounted for 18.9% of all laptops and desktops sold in U.S. retail outlets. For computers priced above $1,000, Apple's share was an astonishing 89%.

The NPD numbers overstate Apple's dominance to some degree. They exclude most sales to large enterprises, which strongly prefer high-end PCs to Macs. Still, the business implications are inescapable. While competitors such as Hewlett-Packard, Acer, and Dell sell vast volumes of $500 laptops that yield razor-thin profit margins, Apple—whose cheapest MacBook sells for $999—is raking in the lion's share of the industry's profits.

Apple is in every sense a mass marketer, but it has the soul and the strategy of a luxury-goods maker. You can see this in the design of its products, right down to the packaging. The appeal is visceral: To see the product is to want it.

I'm writing these words on a 27-inch iMac that is the most gorgeous desktop I've ever touched. In a world where the design esthetic is industrial blah, the new iMac ($1,999 for the 27-in. model, from $1,199 for the 21.5-in.) is a spare, elegant fusion of aluminum and glass that features everything you need and nothing you don't. The accompanying Magic Mouse is a curved sliver of plastic with a touch-sensitive top that lets you scroll with the flick of a finger. The wireless keyboard looks like something from the Bang & Olufsen store.



The 27-inch iMac provides everything a user needs in a sleek, gorgeous form

Luxury-goods makers are quirky, and Apple is no exception. It has a long-standing antipathy to multibutton mice, so the Magic Mouse comes with its right-click function disabled until you change a preference to turn it on. And the keyboard pointlessly embraces all the limitations of a laptop keyboard—no number pad, no keys for paging up and down. Fortunately, if you want to trade beauty for functionality, standard Microsoft and Logitech International keyboards and mice work just fine with Macs.

Steve Jobs on the low end of the market: "We don't know how to build a sub-$500 computer that is not a piece of junk"

Apple also disdains the mass marketers' credo that there should be a product tailored to every taste. HP's U.S. online store offers 35 different laptop models, from a $300 netbook to $1,300-plus monster with an 18.4-in. display, each of which is available in multiple configurations. Apple offers just five laptops, and the options for configuring them are limited to disk size, amount of memory, and sometimes processor speed. Every computer Apple makes, from the $599 Mac mini to the 8-Core Mac Pro desktop, which approaches $12,000 when it's fully loaded, comes with the same version of the OS X operating system and the same set of preloaded applications.

Apple's approach causes it to neglect huge swaths of the market. For example, the company serenely ignored analysts' advice that it "had to" break into the hot netbook market. It has avoided the fast-growing segment of low-cost, lightweight consumer notebooks. Entering those markets could boost Apple's share even further. But the move would take a toll on profit margins and fight the company's commitment to choose what types of products it believes best serve its customers' needs. CEO Steve Jobs has dismissed the low end of the market, saying: "We don't know how to build a sub-$500 computer that is not a piece of junk."

Apple has clung to its retrograde philosophy, fighting a tide in which manufacturers target products at minutely sliced-and-diced subsectors of the market. But the philosophy still works, and, happily, Apple is unlikely to outgrow it. | BW |

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(TOP) BRAD TRENT

COMPANY INDEX

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names.
Companies listed only in tables are not included.

A Abbott Laboratories (ABT) 52
Accel Partners 46
Acer 40, 70, 82
Activision (ATVI) 57
AcuNetx 72
AdMob 6
ADP (ADP) 64
Aetna (AET) 34
Aging in Place Technology 72
AIA 24
AIG (AIG) 6
Allianz (AZ) 24
Allstate (ALL) 69
Almond Hill Enterprises 64
Amazon (AMZN) 57
American Express (AXP) 72
Amgen (AMGN) 52
Amtran Technology 40
Anthem Blue Cross 34
Apple (AAPL) 28, 46, 52, 82
A.R. Schmeidler 76
Astellas 52
Atari 46
Au Optronics (AUO) 40
Autodesk (ADSK) 66
Aviva 24
AXA (AXA) 6, 24
B Bang & Olufsen 82
Bank of the West 68
Barnes & Noble (BKS) 28
Bausch & Lomb 34
Bear Stearns 6
Best Buy (BBY) 57
Biogen Idec (BIIB) 26
Blackstone Group (BX) 13
Bloomberg 6
Boeing (BA) 68
BP (BP) 54
Brookhaven Capital 76
Burrill 52
C CA (CA) 30
Cadbury (CBY) 6, 26
Carret Asset Management 69
Cascade Alpacas 72
CashEdge 68
CBS (CBS) 72
Cerberus Capital 6
China Life (LFC) 24
China National Gold 76
China Water & Energy 46, 50
Chrysler 6, 16
Cigna (CI) 24
CNBC 13
CNinsure (CISG) 24
Cofco 24
Comcast (CMCSA) 6
ConocoPhillips (COP) 69
Cooper Tire & Rubber (CTB) 76
Craigslist 72
CSM Worldwide 62
CWE 50
D Dell (DELL) 40, 70, 82
Deloitte 6, 52
Deutsche Bank (DB) 6
Discover Financial (DFS) 64
Driptech 46, 53
E East Japan Railway 16
Eastman Kodak (EK) 34
eBay (EBAY) 68
EDF 60
Electronic Arts (ERTS) 57
Emerging Global Advisors 69
Energy Select Sector SPDR (XLE) 69
Eni (E) 60
Epizyme 46, 52
ESPN 57
ExxonMobil (XOM) 54, 69
F Facebook 46
Facet Biotech (FACT) 26
Far Eastern Department Stores 70
Fiat (FIATY) 6, 16
FIS (FIS) 68
Fiserv 68
Flickr (YHOO) 46
Forest City Entertainment (FCE) 71
Forrester Research (FORR) 72
From Where I Sit 72
G Galleon Group 6
GameStop (GME) 57
Gartner (IT) 28
Gazprom 60
GE (GE) 6, 22, 34, 50
Geary Advisors 69
Genentech 26, 46
General Motors 6
General Growth Properties (GGP) 71
Genzyme (GENZ) 76
GlaxoSmithKline (GSK) 34, 52
Glier's Meats 64
Glu Mobile 28
Google (GOOG) 6, 28, 40, 46
Guangxi State Farms 22
Guodianxiangyun Wind 50
H Haier 24
Hang Lung Properties (HLPPY) 71
Hang Seng Bank 50
Hapoalim Securities 76
Henderson Land (HLDCY) 71
Hon Hai Precision 70
HP (HPQ) 6, 40, 46, 70, 82
HTC 40, 70
Hunch 46
Hyundai 62
I IBM (IBM) 52
IHS Global Insight 16, 64
ING (ING) 52
Invesco Greater China Equity 70
iShares MSCI Taiwan Index 70
J J&J (JNJ) 34
Javelin Strategy 68
J.D. Power (MHP) 62
Jefferies (JEF) 32
JPMorgan Chase (JPM) 18, 70
K KeyBanc Capital 76
Kimco Realty Trust (KIM) 71
KlingStubbins 66
Kraft Foods (KFT) 6, 26
L Layar 52
Leo Burnett 72
Logitech (LOGI) 82
M Manulife Financial (MFC) 24
Maruti-Suzuki 62
Marvell Technology (MRVL) 6
MasterCard (MA) 68
Mattel (MAT) 66
McDonald's (MCD) 32, 52
McGladrey Capital 26
McKinsey 40, 50, 54
Mercatus 68
Mercer 34
Meyer Scherer 66
Microsoft (MSFT) 28, 40, 52, 82
Millennium Pharmaceuticals 52
Morningstar (MORN) 69
Morrison & Foerster 26
Motorola (MOT) 6, 28
MPM Capital 52
N NBC Universal 6
Neal Publications 16
New Energy Finance 54
Newhall Land Development 71
Newmont Mining (NEM) 76
News Corp (NWS) 26
New York Life 24
Niconovum 6
Nissan (NSANY) 62
Nokia (NOK) 28, 52, 68
Nordstrom (JWN) 72
NPD Group 32, 57, 82
Nvidia (NVDA) 40
O Obopay 68
Opel 6
Oppenheimer (OPY) 76
Oracle (ORCL) 6
OZ Minerals 76
P PayPal (EBAY) 68
Pepsi Bottling (PBG) 26
PepsiCo (PEP) 26
Phycal 54
Ping An 24
PNC Financial (PNC) 68
Postini 53
Priceline.com (PCLN) 6
ProLogis (PLD) 71
Protalix BioTherapeutics (PLX) 76
PSA-Peugeot Citroën 62
PwC 46
Q Quanta Computer 40, 70
R RBS Sempra Commodities 60
Reynolds American (RAI) 6
RIM (RIMM) 28, 40
Rio Tinto (RTP) 76
RiskMetrics 26
Roche (RHHBY) 26
Royal Dutch Shell (RDS) 54
S SAC Capital 6
S&P (MHP) 6, 13, 20, 26, 69

CORRECTIONS & CLARIFICATIONS

"A Brutal Wakeup Call for Part-Time B-Schools" (In Depth, Nov. 16) misidentified Gordon Armstrong. He is the director of marketing communication and competitive intelligence at Duke Corporate Education. A table accompanying the article misreported the tuition for Wake Forest University's part-time MBA program. It is $1,230 per credit hour.

"Country Clubs: Stuck in the Rough" (Golf & The Business Life, Nov. 9) mistakenly said the Country Club of Lansing, Mich., was in foreclosure. The club says it filed for protection under Chapter 11 to avoid foreclosure and expects to emerge from bankruptcy by early next year.

Schlumberger (SLB) 69
Semiconductor Manufacturing 6, 70
Sequoia Capital 46
Sinochem 24
Slade Architecture 66
Sony (SNE) 40
SPDR S&P 500 Fund (SPY) 69
Sprint Nextel (S) 70
Starbucks (SBUX) 33
Sun Microsystems (JAVA) 6
Sunstone Capital 52
SurePayroll 64
T Taiwan Fund (TWN) 70
Taiwan Semiconductor (TSM) 6, 40, 70
Tata Motors (TTM) 62
Technomic 32
Texas Large Cos. ETF (TXF) 69
Third Avenue Real Estate (TAREX) 71
Thomson Reuters (TRI) 26, 34
3Com (COMS) 6
Transworld Oil 60
U UBS (UBS) 24
UnitedHealth (UNH) 34
United Microelectronics (UMC) 40
Urban Outfitters (URBN) 66
U.S. Bancorp (USB) 68
V Value Partners 70
Viacom (VIA) 57
Visa (V) 68
Vivendi 6
Volkswagen (VLKAY) 62
Vornado Realty Trust (VNO) 71
W Wal-Mart (WMT) 52, 57
Wedbush Morgan 57
Wegmans Food Markets 34
WellPoint (WLP) 34
Wendy's Arby's (WEN) 32
Wistron 40
X Xerox (XRX) 34
Y Yahoo! (YHOO) 46
YouNoodle 48
YouTube (GOOG) 57
Z Zacks Investment Research 76

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The Dark Side of Incentives

They consistently backfire when efforts to boost bonuses override moral considerations

Right now, there's little that makes a typical American taxpayer more resentful than the huge bonuses being dispersed at Wall Street firms. The feeling that something went terribly wrong in the way the financial sector is run—and paid—is widespread. It's worth recalling that the incentive structures now governing executive pay in much of the corporate world were hailed as a miracle of human engineering a generation ago when they focused once-complacent CEOs with laser precision on steering companies toward the brightest possible futures.



So now there's a lot of talk about making incentives smarter. That may improve the way companies or banks are run, but only temporarily. The inescapable flaw in incentives, as 35 years of research shows, is that they get you exactly what you pay for, but it never turns out to be what you want. The mechanics of why this happens are pretty simple: Out of necessity, incentives are often based on an index of the thing you care about—like sound corporate leadership—that is easily measured. Share price is such an index of performance. Before long, however, people whose livelihoods are based on an index will figure out how to manipulate it—which soon makes the index a much less reliable barometer. Once share price determines the pay of smart people, they'll find a way to move it up without improving—and in some cases by jeopardizing—their company.

Incentives don't just fail; they often backfire. Swiss economists Bruno Frey (University of Zurich) and Felix Oberholzer-Gee (Harvard Business School) have shown that when Swiss citizens are offered a substantial cash incentive for agreeing to have a toxic waste dump in their community, their willingness to accept the facility falls by half. Uri Gneezy (U.C. San Diego's Rady School of Management) and Aldo Rustichini (University of Minnesota) observed that when Israeli day-care centers fine parents who pick up their kids late, lateness increases. And James Heyman (University of St. Thomas) and Dan Ariely (Duke's Fuqua School of Business) showed that when people offer passers-by a token payment for help lifting a couch from a van, they are less likely to lend a hand than if they are offered nothing.

What these studies show is that incentives tend to remove the moral dimension from decision-making. The day-care parents know they ought to arrive on time, but they come to view the fines as a fee for a service. Once a payoff enters the picture, the Swiss citizens and passersby ask, "What's in my best interest?" The question they ask themselves when money isn't part of the equation is quite different: "What are my responsibilities to my country and to other people?" Despite our abiding faith in incentives as a way to influence behavior in a positive way, they consistently do the reverse.

Some might say banking has no moral dimension to take away. Bankers have always been interested in making money, and they probably always will be, but they've traditionally been well aware of their responsibilities, too. Bankers worried about helping farmers get this year's seed into the ground. They worried about helping a new business get off to a strong start or a thriving one to expand. They worried about a couple in their 50s having enough to retire on, and about one in their 30s taking on too big a mortgage. These bankers weren't saints, but they served the dual masters of profitability and community service.

In case you think this style of banking belongs to a horse-and-buggy past, consider credit unions and community development banks. Many have subprime mortgage portfolios that remain healthy to this day. In large part, that's because they approve loans they intend to keep on their books rather than securitizing and selling them to drive up revenue, which would in turn boost annual bonuses. And help bring the world economy to its knees.

At the Group of 20 gathering in September, France and Germany proposed strict limits on executive pay. The U.S. now has a pay czar, who just knocked down by half the compensation of 136 executives. But the absolute amounts executives are paid may be inconsequential. Most people want to do right. They want their work to improve the lives of others. As Washington turns its sights on reforms for the financial sector, it just might consider nudging the industry's major players away from the time-dishonored tradition of incentives and toward compensation structures that don't strip the moral dimension away from the people making big decisions. |BW|

Barry Schwartz is professor of psychology at Swarthmore College and the author of The Paradox of Choice: Why More Is Less.

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